Vol. I

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1943

No. 195

NORTHWESTERN ELECTRIC COMPANY, AND AMERICAN POWER & LIGHT COMPANY, PETITIONERS,

vs.

FEDERAL POWER COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 23, 1943.

CERTIORARI GRANTED OCTOBER 11, 1943.

No. 9756

United States

Circuit Court of Appeals

For the Ninth Circuit.

NORTHWESTERN ELECTRIC COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent.

Transcript of Record

In Three Volumes

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Upon Petition to Review an Order of the Federal Power Commission

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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United States

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United States of America
Federal Power Commission

Commissioners: Leland Olds, Chairman; Claude L. Draper, Basil Manly, John W. Scott, Clyde L. Seavey.

June 18, 1940

Docket No. IT-5642

In the Matter of

NORTHWESTERN ELECTRIC COMPANY

ORDER TO SHOW CAUSE AND FIXING DATE FOR HEARING

Upon consideration of the report entitled "Reclassification of Plant Accounts as of January 1, 1937" mailed to the Federal Power Commission by the Northwestern Electric Company of Portland, Oregon, on May 27, 1939; the joint "Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937," made by the staffs of the Federal Power Commission and the Public Utilities Commissioner of Oregon and served upon the Northwestern Electric Company, with a letter of transmittal, by the Federal Power Commission on May 1, 1940; Northwestern Electric Company's written reply to the joint report dated May 31, 1940; and other related information on file with this Commission:

The Commission finds that:

(a) Northwestern Electric Company's abovementioned report and reply do not set forth sufficient information which would justify or explain the Company's reason for failure to adjust its books of account in complete accordance with the joint "Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937" made by the staffs of this Commission and the Public Utilities Commissioner of Oregon;

(b) Under the provisions of Section 301(a) of the Federal Power Act, the Company has the burden of proof to justify every accounting entry questioned by this Commission, and it is advisable, necessary and proper in the public interest that a public hearing be held for the purpose of requiring the Northwestern Electric Company to show cause why this Commission should not order the adjustment of the Company's accounts to conform with the aforementioned joint "Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937";

The Commission, therefore, orders that:

(1) A public hearing be held on July 15, 1940, at 10 a. m., in the Circuit Court of Appeals Court Room 704, U. S. Courthouse Building, Portland, Oregon, and that at the hearing the Northwestern Electric Company show cause

why the Federal Power Commission should not find and determine by order that adjusting entries be made to bring the books of account in conformity with the joint "Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937";

(2) The Public Utilities Commissioner of Oregon and the Washington Department of Public Service may participate in the hearing as provided in Part 39, Section 39.4 of this Commission's Rules of Practice and Regulations prescribed pursuant to the provisions of the Federal Power Act.

By the Commission.

LEON M. FUQUAY,
Secretary.

[Title of Board and Cause.]

MOTION TO DISMISS

Northwestern Electric Company, as the Respondent in the above entitled matter, respectfully moves that this proceeding be dismissed on the following grounds:

First: That this Commission both in its Order to Show Cause entered in the above entitled matter on June 18, 1940, and in its so-called Uniform System of Accounts prescribed for Public Utilities and Licensees, effective January 1, 1937, (hereinafter called the System of Accounts), attempts to assume

comprehensive accounting jurisdiction not only over the project property of licensees and facilities subject to the jurisdiction of this Commission which are owned or operated by public utilities, but also over properties and operations both of licensees and of public utilities which are, by express provision of the Federal Power Act (hereinafter called the Act), excepted and removed from the jurisdiction of this Commission. This attempt on the part of this Commission to extend Federal regulation to matters which are subject to regulation by the States violates both the letter and the spirit of the Act.

Second: That the System of Accounts is neither necessary nor appropriate for the purposes of the Act and does violence both to the letter and the spirit of the Act: (a) in that it attempts to assume accounting jurisdiction over properties and operations not subject to the jurisdiction of the Commission, as more fully set forth in paragraph First hereof; (b) in that it (said System of Accounts), as apparently interpreted by the Commission and its staff, is intended to exclude certain of the elements which comprise original cost and that, in particular, it is impossible for a licensee or public utility to comply with the mandatory provision contained in sub-paragraph A of paragraph 2 of "Instructions—Electric Plant Account", at page 37 of said System of Accounts, and at the same time observe the contradictory statement of negative intention expressed in sub-paragraph B of said paragraph

2 at page 38 of said System of Accounts; and (c) in that Account No. 107, entitled "Electric Plant Adjustments", appearing at page 19 of said System of Accounts, cannot be complied with in its present form because, as a "catch-all" account, it is ambiguous, indefinite and not susceptible of accurate application, such account requiring, among other things, the disclosure of "write-ups", which term has not been defined in said System of Accounts, despite the many and widely varying interpretations given said term both in the reports of the Federal Trade Commission and elsewhere. In the foregoing and in other respects the said System of Accounts is at odds with fundamental principles of correct accounting.

Third: That the Commission's said Order to Show Cause, which here serves only the purpose of a notice of hearing, directing the Respondent to appear and show cause why it should not be required to adjust its books of account to conform with the joint report of the staffs of the Commission and the Public Utilities Commissioner of Oregon which was served upon Respondent with the Commission's letter of transmittal of May 1, 1940, is indefinite and uncertain and fails to apprise Respondent of the issues of said hearing, or the ground taken by the Commission which the Respondent is called upon to answer, so as to enable it adequately to prepare for said hearing, in the following respects:

1. The said joint report which, under the practice of the Commission, represents only the opinion of the examiners who prepared it as to the accounting principles and rules involved, has not been adopted by the Commission as a statement of the facts or accounting questions with respect to which Respondent is required to answer, is effectually disclaimed as a statement of the issues of such hearing by the Commission's letter of transmittal, and is inconsistent with and repugnant to the orders and instructions of the Commission under which such Respondent's own report entitled "Reclassification of Plant Accounts as of January 1, 1937" was prepared and filed. Respondent therefore cannot ascertain whether the issues of such hearing raise questions of compliance or noncompliance with said System of Accounts or involve asserted accounting principles and practices which are independent of said System of Accounts and are not disclosed to Respondent.

2. With respect particularly to the proposed adjustment entitled "Reversal of Restatement of Interest During Construction", the said joint report proposes that costs incurred by Respondent for such interest be excluded from its plant account notwithstanding the fact that, as provided by said System of Accounts, such interest is a component of construction cost, was ascertained by analysis of Respondent's records, and is included at the cost incurred by Respondent pursuant to the direction

that stated costs shall include all items and components of cost. The said opinion of the examiners and the proposal that such interest be eliminated are not based upon or made with reference to any instruction or direction in said System of Accounts which provides for the exclusion of such interest and are inconsistent therewith and contradictory thereof.

3. The said joint report also proposes an adjustment of Respondent's accounts by a transfer of certain items of its plant from "Electric Plant in Service", Account No. 100.1, to "Common Utility Plant", Account No. 108, which proposal is rested solely upon the opinion of the examiners that such transfer should be effected and is not supported by, but is contradictory to, the provisions of said System of Accounts.

4. The proposals of said Examiner with respect to the foregoing and other proposed adjustments are based upon the assertion that "It is the opinion of the examiners that the reclassification of plant pursuant to Instruction 2-D was not intended to require or permit a reaccounting of a utility's construction costs." But said Report also proposes that an amount of $3,500,000 representing common stock classified by the Respondent in Account No. 391, Organization, be transferred to Account No. 107 pending the submission to the Commission of a plan for its disposition. Such proposal is rested upon the provision of said System of Accounts that amounts included in Account No. 107 shall be dis-

posed of as the Commission may approve or direct, and the asserted ground that said charges are not presently supported to the satisfaction of the examiners, notwithstanding the fact that a disposition thereof involves determination of legal rights and a reaccounting of items now recorded on Respondent's books of account. The intention of the Commission to effect such reaccounting is confirmed by the said letter of transmittal which expressly requests the submission of a plan for disposing of the amount of $3,500,000 set forth on page 29 of the said joint report under Account 107 and by other action of the Commission requiring similar reaccountings.

5. Said order recites that "The Public Utilities Commission of Oregon and the Washington Department of Public Service may participate in the hearing", but does not apprise Respondent of the character of such hearing as a joint hearing or a hearing to be conducted by the Federal Power Commission alone. Respondent is therefore unable to determine what jurisdiction is asserted over its accounts and practices or whether the issues of said hearing involve both Federal and State matters or Federal matters alone and is without information as to the issues raised or which may be raised by said state regulatory authorities.

Fourth: The Commission is without jurisdiction to proceed further under said Order to Show Cause and the proceedings thereunder ought to be dis-

missed on the ground that the regulation of intrastate business and opefations sought to be enforced under and by virtue of said System of Accounts is not a regulation of commerce, nor on the subject of bankruptcies, within the meaning of the applicable clauses of Article I, Section 8 of the Constitution of the United States, and is not within any other power vested in the Congress by said Constitution, but is an invasion of the powers reserved to the states or the people within the meaning of Article X of the amendments to the Constitution of the United States and the regulation sought to be enforced would deprive Respondent of property without due process of law in violation of Article V of the amendments to the Constitution of the United States, and on the further ground that the indefiniteness and uncertainty of the notice of hearing herein are, as more particularly set forth in Paragraph Third hereof, not adequate notice of the proceedings to be taken by the Commission within the requirements of the due process clause of Article V of the amendments to the Constitution of the United States. In filing this motion and accompanying preliminary brief, the Respondent expressly reserves and refuses to waive any Constitutional or legal rights and expressly reserves the right to contest the Constitutionality of any provision of the Federal Power Act as applied to it or of any rule, regulation, or order now or hereafter made or purported to be made thereunder.

In the absence of any specific provision with respect to such matters in the Rules of Practice and Regulations of the Commission, the Respondent files with this motion a preliminary brief of argument in support thereof and respectfully requests an oral argument thereon and the privilege of filing a more comprehensive brief either prior to or after such oral argument, as the Commission may direct.

Dated at Portland, Oregon
July 15, 1940.

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[Title of Board and Cause.]

ORDER DENYING MOTION TO DISMISS

Upon consideration of Northwestern Electric Company's motion to dismiss this proceeding and its supporting brief filed on July 17, 1940, the Com-

mission's Order to Show Cause and Fixing Date for Hearing adopted on June 18, 1940, and all relevant matter on file with this Commission;

The Commission finds that:

No sufficient reason has been presented to justify granting the motion to dismiss this proceeding and that oral argument with an *an* additional brief in support of the motion would be unnecessary;

The Commission, therefore, orders that:

The motion to dismiss this proceeding be and it is hereby denied.

By the Commission.

LEON M. FUQUAY,
Secretary.

[Title of Board and Cause.]

ANSWER

Northwestern Electric Company, as the Respondent in the above entitled matter, initiated by the Commission's "Order to Show Cause and Fixing Date of Hearing", dated June 18, 1940 (hereinafter called the "Order"), makes answer to said "Order" as follows:

This answer is submitted with respect to the above described Order, although not required thereby, as a statement of the Respondent's position on issues which appear to be raised (a) by said Order, (b)

by the joint "Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937" made by the staffs of the Commission and the Public Utilities Commissioner of Oregon (hereinafter called "Joint Report"), referred to in said Order, and (c) by the so-called Uniform System of Accounts prescribed by this Commission for Public Utilities and Licensees, effective January 1, 1937, (hereinafter called the "System of Accounts") in so far as the Respondent has been apprised of said issues, or the ground taken by the Commission which the Respondent is called upon to answer, and for the purpose of attempting, in so far as possible, to clarify such issues for the purposes of the hearing to be held pursuant to said Order.

This answer is filed without waiver of, but with renewed insistence upon, the Motion to Dismiss filed by Respondent with this Commission on July 17, 1940, and also is filed subject to and reserving to the Respondent all constitutional and legal rights as more fully set forth and stated in paragraph Fourth of Respondent's said Motion to Dismiss.

The Commission's said Order asserts that the report entitled "Reclassification of Plant Accounts as of January 1, 1937", mailed to the Commission by Respondent on May 27, 1939, and Respondent's reply (dated May 31, 1940) to the Joint Report, do not set forth sufficient information to justify or explain Respondent's reason for its failure to adjust its books of account in complete accordance with said Joint Report, and requires Respondent to show

cause why this Commission should not find and determine by order that adjusting entries should be made to bring Respondent's books of account in conformity with said Joint Report.

I.

The history of the organization, financing and development of the Respondent is essential to a fair and proper consideration of the issues apparently to be determined herein, and Respondent therefore alleges the important facts of such history, as follows:

Organization of Respondent

In 1910 the owners of a paper mill at Camas, Washington, about twenty miles east of Portland, Oregon, in need of a dependable supply of power for their operations, employed engineers who carried on investigations for several months surveying a number of streams and finally selected a site for a hydro-electric power plant on the White Salmon River, about sixty miles east of Portland. These paper mill owners, who were residents of San Francisco, incorporated Northwestern Electric Company under the laws of the State of Washington in January, 1911. Through that Company, they proceeded to construct a hydro-electric generating plant and to build a transmission line to said paper mill at Camas, with which the new electric company entered into a long-term contract to supply power. The plans of Northwestern Electric Company and its organizers were expanded to include a general util-

ity business in Portland, where the Company succeeded in obtaining a franchise late in 1912, after considerable opposition from the owners of the electric utility already long established there. As stated at page 14 of the Joint Report, the effective date of plant operation was July 1, 1914.

From the beginning of investigations and surveys until early in 1912, funds to carry on the enterprise were provided entirely by the organizers. A much larger financing problem than ordinarily was found even in the early day of the utility business was involved with the entry of this Company into the competitive field in the City of Portland. Without established credit, and with no record of earning ability, it was not possible at that time to undertake any permanent financing of the Company. The organizers were obliged to continue to carry and to increase the risk of supplying their cash and credit to the new Company. To make it possible for the Company to obtain funds during its initial construction period, the organizers of the business found it necessary to guarantee short-term obligations of the Company, and thus supply the credit which the Company could not have established by itself. As construction progressed, these guaranteed obligations reached a sum of approximately $3,000,000.

It was not until 1915 that the credit of the Company had become sufficiently well established to make possible a sale of preferred stock and of

Twenty-Year First Mortgage 6% bonds, from the proceeds of which the short-term obligations could be retired.

The principal organizers served in executive and administrative capacities from the Company's incorporation to March, 1925, having served without compensation until after the Company had passed through the initial development period and was ready for permanent financing. They gave their personal attention and direction to the acquisition of lands and water rights for the hydro-electric project, to the purchasing of supplies and equipment, to administrative and general supervision of construction and to the securing of important franchises, and provided the general direction of the Company's business and corporate matters. They negotiated the short-term obligations referred to above, guaranteeing them in large part by their own endorsements, and in due course sold, by their own efforts and at their own expense, approximately $1,800,000 in par value of 6% Preferred Stock of the Northwestern Company.

For these promotional activities of the organizers and their executive and administrative services, for the risk they incurred in furnishing capital and in guaranteeing the Company's obligations for large sums invested in this unproved and venturesome enterprise, and for their efforts and costs incurred in selling said preferred stock issue, the organizers were compensated by the issuance to them or their

order of the 100,000 authorized shares of the Company's common stock. These organizers devoted approximately 45,000 or 45% of these shares directly to the Company's benefit by turning them over without charge to the subscribers for the preferred stock on a pro rata basis, in order to make the preferred stock more attractive and salable.

During the ten years from 1915 to 1925, the continued growth of the business in Portland, particularly during and after the World War period, necessitated the building of an additional large steam electric generating plant in Portland, and the transmission line from the Company's hydro-electric plant was also extended to serve Vancouver, Washington, and adjacent territory. The financing of these property additions was done under the guidance and financial sponsorship of the organizers.

Purchase by American Power & Light Company

In 1925, American Power & Light Company (hereinafter sometimes called "American" or "American Company") acquired control of the Company through the purchase of all its common stock at a cost of $5,095,946.48 (see page 4 of the Joint Report) and thereafter assumed the responsibility for providing the funds necessary to finance the continued growth of the business and for assuring the Northwestern Company a progressive and capable management. In the following year, distribution systems owned by an associate company of American Company in adjoining territory were

leased for operation by the Northwestern Company, and subsequently service was extended to other neighboring communities, so that now nearly thirty communities and large rural areas are served by the Northwestern Company, the greater part of the business, however, still being in Portland. Transmission lines were also constructed to connect with the lines of Pacific Power & Light Company, an associate company, and the Northwestern Company has now become an integral part of an interconnected system of associate companies, extending through Washington, Oregon, Idaho and Montana and providing the Northwestern Company with valuable auxiliary sources of power and energy as needs or opportunities for use thereof occur.

In 1929, however, it was not possible for the Northwestern Company to finance the construction of the additional power facilities then required to meet the growing demand for its service, because its Portland electric franchise expired by its terms in 1937, the maximum additional amount of bonds issuable under its mortgage indenture was inadequate, even if it would have been possible to sell all of such issuable remainder on reasonable terms, and the negotiation of a new bond issue did not then appear at all feasible. In that year, Inland Power & Light Company, then a direct subsidiary of the American Company, began the construction of a hydro-electric power plant on the Lewis River in the State of Washington, which was completed

in 1931 with an installed capacity of 45,000 kilowatts, at a cost of more than $8,000,000. The major part of the power output of this plant was contracted to the Northwestern Company. This project solved a serious power supply problem for the Company, in addition to providing an important addition to the power resources of an integrated public utility system in the Pacific Northwest.

Badly handicapped by the limitations of its bond mortgage, the Northwestern Company was obliged to borrow on unsecured obligations to obtain the funds necessary for property additions required to take care of the growing opportunities and demands for its electric service. With its mortgage bonds maturing May 1, 1935, and its franchise in Portland expiring in October, 1937, the Company would have found it very difficult, if not impossible, to borrow from banks or other sources on unsecured obligations.

American Power & Light Company, the owner of Northwestern's common stock, assumed this responsibility and from December, 1925, to October, 1939, made total loans to the Company of $12,210,000, the maximum amount outstanding at any one time being $3,662,000 in January, 1930. In view of the fact that the date of maturity of these loans was indefinite, and repayment was conditioned upon Northwestern Company's ability to finance in the indefinite future, under unknown conditions, and the further fact that the principal franchise of

Northwestern Company was expiring in a few years with no assurance of extension, no one but the American Company, the equity stockholder, was able and willing to assume this responsibility in the interests of Northwestern Company and the public served by it. Although Northwestern Company was able to reduce its loans somewhat from the January, 1930, maximum, the balance still due to the American Company at the end of 1934 was $2,819,000.

Bond Extension and Subsequent Refunding Operation

In January, 1935, it was evident that refunding of the Northwestern Company's bonds, due in May of that year, would be impossible. The construction by the Federal Government of the Bonneville hydroelectric project near Portland was well under way; the Company had not succeeded in renewing the Portland franchise which would expire in 1937; the Company obtained approximately 70% of its gross revenues in that city; and bankers were not willing to purchase a new issue of bonds in the face of such conditions. A default in the payment of the principal of the bonds at their May, 1935, maturity, and receivership and foreclosure were imminent, unless the bondholders could be induced voluntarily to consent to an extension of the bond maturity.

Plans for a ten-year extension of the bond maturity were worked out with the aid of the American Company and submitted to some of the larger bondholders, but no plan was acceptable to them

unless American would make further substantial commitments. American Company agreed that it would neither demand nor accept any payment by the Northwestern Company on its $2,819,000 indebtedness to the American Company, while any of the extended bonds were outstanding, and also agreed to a provision that if any dividends were paid on the Northwestern Company's preferred stock, an amount equal to one-third of such dividend payments should be paid into the bond sinking fund, which already required very substantial annual cash payments by Northwestern Company. American further agreed that no dividend should be paid on the Northwestern Company's common stock until the bonds had been retired, thus deferring any opportunity of American Company to receive any income from its common stock investment to a more favorable future period. Unless American Company had been able and willing to assume these responsibilities, the interests of the preferred stockholders and of the public served would have been seriously prejudiced. The plan thus supported by the American Company was submitted to all the bondholders of the Northwestern Company, and the ten-year extension of the bond maturity date was successfully accomplished.

From a total of $6,656,000 principal amount at the time of the maturity extension, the amount of bonds outstanding was reduced through the operation of the sinking fund to less than $5,400,000 in October,

1939, at which time arrangements were made for the sale to insurance companies of a new issue of Thirty-year 4% bonds. The new 4% bonds were issued in the principal amount of $6,700,000 and the proceeds were used to retire the outstanding extended 6% bonds and to reimburse the treasury for capital additions, thus permitting payment to preferred stockholders of the remaining arrears in dividends which had accumulated principally during the years from 1933 through 1935. To make this issue of bonds more inviting, and further to improve the position of the preferred stockholders, American Company converted its 6% loan to Northwestern Company into $2,800,000 of unsecured Twenty-year 4½% debentures. By this acceptance of debentures, American now has a 4½% Twenty-year unsecured obligation in place of 6% notes which would have become a demand obligation of the Company upon the retirement of the former extended bonds.

As of May 31, 1940, the Northwestern Company had an earned surplus of $1,138,000, representing equity earnings accruing to the common stockholder which in effect have been plowed back into the business of the Northwestern Company.

Present Capital Structure of Company

Northwestern Electric Company has outstanding the following securities:

(a) Bonds—First Mortgage Bonds, 4% Series, Due 1969—$6,700,000.

(b) Debentures—4½% Debentures, Due 1959—$2,800,000.

(c) Stock—First Preferred, 7 % cumulative, $100 par value, with priority over the 6% Preferred and Common Stock as to dividends, and in liquidation—47,593 shares issued, 326 shares reacquired, 47,267 shares outstanding—each share entitled to one vote at stockholders' meetings.

(d) Stock—Original Preferred, 6% cumulative, $100 par value, with priority over the Common Stock as to dividends and in liquidation, convertible into First (7%) Preferred Stock at the rate of 9/10 share of the latter for each full share of the 6% Preferred Stock—555 shares outstanding—each share entitled to one vote at stockholders' meetings.

(e) Stock—Common Stock, $35 par value—100,000 shares issued and outstanding—each share entitled to one vote at stockholders' meetings.

Of these outstanding securities, the 47,822 shares of preferred stock and the 100,000 shares of common stock have voting rights, share for share. The present status of these 100,000 shares of Common Stock was approved and confirmed by the vote of the stockholders twenty-five years after the Company's organization, at a meeting held on due notice to all stockholders on September 16, 1936. At that meeting the holders of 27,234 shares of Preferred Stock were present in person or by proxy, and voted unanimously to authorize the conversion of

the previously outstanding 100,000 shares of Common Stock of the par value of $100 per share, then held by American Power & Light Company, into 100,000 fully-paid shares of Common Stock of the par value of $35 per share. As stated in said Joint Report, authority for this reduction was granted by the Department of Public Service of the State of Washington by Order No. 6969 under date of September 3, 1936, and by the Public Utilities Commissioner of Oregon by Order No. 3664 entered on September 2, 1936.

Present Condition of the Company

Northwestern Electric Company is a sound, going concern; it is meeting its obligations in full; it has no bank loans, no short-term debt other than current accounts; it has no tax arrearages; and on May 31, 1940, it had on hand cash and other current assets of more than $1,200,000. Its property is in first class operating condition; it has a trained and experienced personnel of more than 530 persons; it is rendering first-class service, and it is meeting all demands for new and additional service, this latter being an especially important consideration with a huge national defense program getting under way.

As shown by the chart attached hereto as Exhibit "A", the number of direct electric customers served by the Company's entire system has increased from 8,493 in 1915 and from 20,971 in 1925 to 37,533 in 1939. Taxes charged to operation have increased

from $55,405 in 1915 and from $270,811 in 1924 to almost $800,000 in 1939, while operating taxes per direct customer (electric and steam) have increased from $6.44 per customer in 1915 to $20.06 per customer in 1939; and from 10.13c per dollar of revenue in 1915 to 16.04c per dollar of revenue in 1939, all as graphically shown on the charts attached hereto as Exhibits "B" and "C".

The Company's average residential consumption per customer has risen from fewer than 450 kilowatt hours in 1923 to 1514 kilowatt hours on a system basis, and 1721 kilowatt hours for Portland alone, in 1939, as compared with the national average for such consumption of only 890 kilowatt hours in 1939, while the average cost of electricity to the Company's residential and farm customers has decreased from more than 4.5c per kilowatt hour in 1923 to 2.59c per kilowatt hour on a system basis, and 2.46c per kilowatt hour for Portland alone, in 1939, as compared with a national average of 4.05c in 1939, all as graphically shown on the charts attached hereto as Exhibits "D" and "E". Further rate reductions effective late in 1939 and early in 1940 will reduce the Company's average system kilowatt hour cost approximately 14% to residential customers to an estimated 2.23c per kilowatt hour, assuming only the 1939 volume of business, and will make Northwestern's rates among the very lowest of all the tax-paying electric utilities of the nation. The chart attached hereto as Exhibit "F" compares the cost of electric service with the cost of

living for the period from 1895 to 1939, showing, in particular, data for living costs in Portland and the average cost per kilowatt hour of residential electric service rendered by Northwestern Company in Portland, for the period from 1921 to 1939.

For the year ending May 31, 1940, the Company earned more than $220,000, or more than 6%, on its outstanding Common Stock. The cost of reproducing the Company's property on December 31, 1938, as shown by an inventory and appraisal of all the properties of the Company prepared by and under the supervision of Ernest C. Willard, an independent consulting engineer residing in Portland, Oregon, was not less than $24,900,000, before depreciation, as against a book fixed capital account, as of the same date, of only $21,099,642, before depreciation.

The favorable attitude of the Company's customers and of the general public in the territory it serves has again been strikingly demonstrated within the last three months when a proposal was submitted to the people of Portland to form a public utility district and to substitute public ownership and operation for the existing private ownership and operation. At an election held in May, 1940, this proposal was voted down by 73,172 to 30,468, or by almost 2½ to 1.

By all of the accepted standards, therefore, Northwestern Electric Company is an asset to the territory it serves and is so recognized by the public. Its service is first-class and adequate, its rates are low and its financial condition is sound. To require the

Company to adjust its books of account in accordance with said Joint Report would necessitate the misstatement of the financial condition of the Company and thus tend to impair its credit, to the detriment of the interests of the Company's investors and consumers.

II.

By Way of Specific Answer to Said Order and Said Joint Report, Respondent Avers:

1. The attempt on the part of this Commission by its said Order, by said Joint Report and by said System of Accounts to assume comprehensive jurisdiction not only over the facilities of the Respondent which are subject to the jurisdiction of the Commission, but also over properties and operations of the Respondent which are, by express provision of the Federal Power Act, accepted and removed from the jurisdiction of this Commission and which comprise the major portion of the properties and operations of the Respondent, violates both the letter and the spirit of said Act and is not a regulation of commerce within the meaning of the applicable clause of Article I, section 8, of the Constitution of the United States, but is an invasion of the powers reserved to the States or the people within the meaning of Article X of the Amendments to the Constitution of the United States, and would deprive Respondent of property without due process of law in violation of Article V of the Amendments to the Constitution of the United States.

2. The said System of Accounts as interpreted

by the Commission and its staff, and as given expression in said Joint Report, excludes from electric plant account elements of actual original cost and thus is arbitrary, capricious and unreasonable, makes impossible the application of uniform standards of accounting in that its determinations of original cost will vary with the historical accounting practices of individual companies, and would deprive the Respondent of property without due process of law, in violation of Article V of the Amendments to the Constitution of the United States. Furthermore, the said System of Accounts is at odds with fundamental principles of correct accounting in that it is impossible for the Respondent (a) to comply with the mandatory provision contained in sub-paragraph A of paragraph 2 of "Instructions—Electric Plant Account", at page 37 of said System of Accounts, and at the same time observe the contradictory statement of negative intention expressed in sub-paragraph B of said paragraph 2 at page 38 of said System of Account, or (b) to comply with Account No. 107, entitled "Electric Plant Adjustments", appearing at page 19 of said System of Accounts, because said Account No. 107, as a "catch-all" account, is ambiguous, indefinite and not susceptible of accurate application, such account requiring, among other things, the recordation of "write-ups", which term has not been defined in said System of Accounts, despite the many and widely varying interpretations given said term both in the reports of the Federal Trade Commission and elsewhere.

3. The said Joint Report also proposes an adjustment of Respondent's accounts by a transfer of certain items of its plant from "Electric Plant in Service", Account No. 100.1, to "Common Utility Plant", Account No. 108, which proposal is rested solely upon the opinion of the examiners that such transfer should be effected, and is not justified by the provisions of said System of Accounts.

Wherefore Respondent prays that this proceeding be dismissed and/or that after due notice of hearing which shall enable Respondent adequately to prepare for such hearing, and upon the presentation of evidence, the Commission grant such other and further relief as in the premises may be just and proper.

Dated July 20, 1940.

LAING & GRAY,
By JOHN A. LAING,
Office and Post Office Address,
Public Service Building,
Portland, Oregon.
REID & PRIEST,
By A. J. G. PRIEST,
SIDMAN I. BARBER,
Office and Post Office Address,
2 Rector Street,
New York, New York,
Attorneys for Respondent.

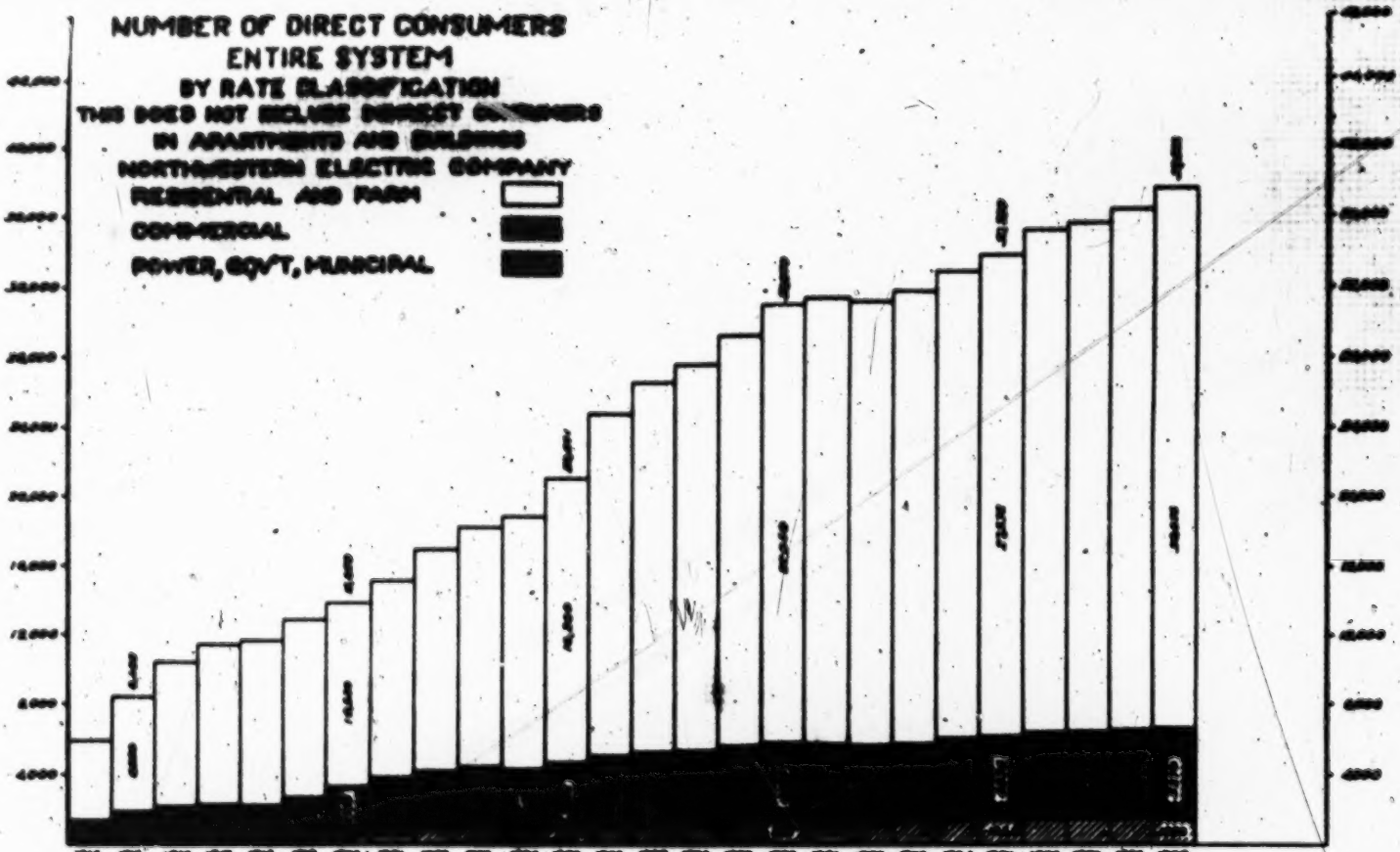
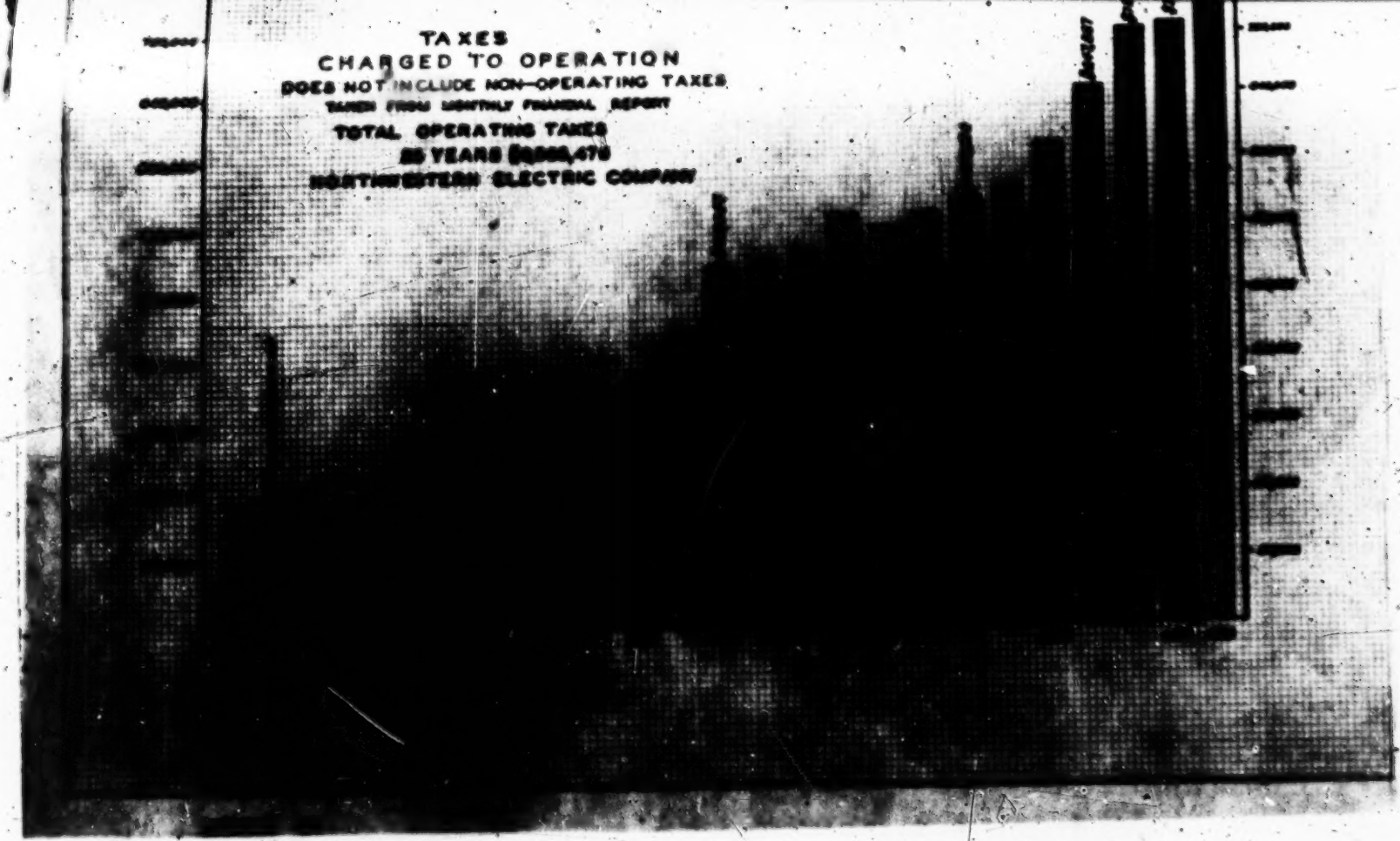
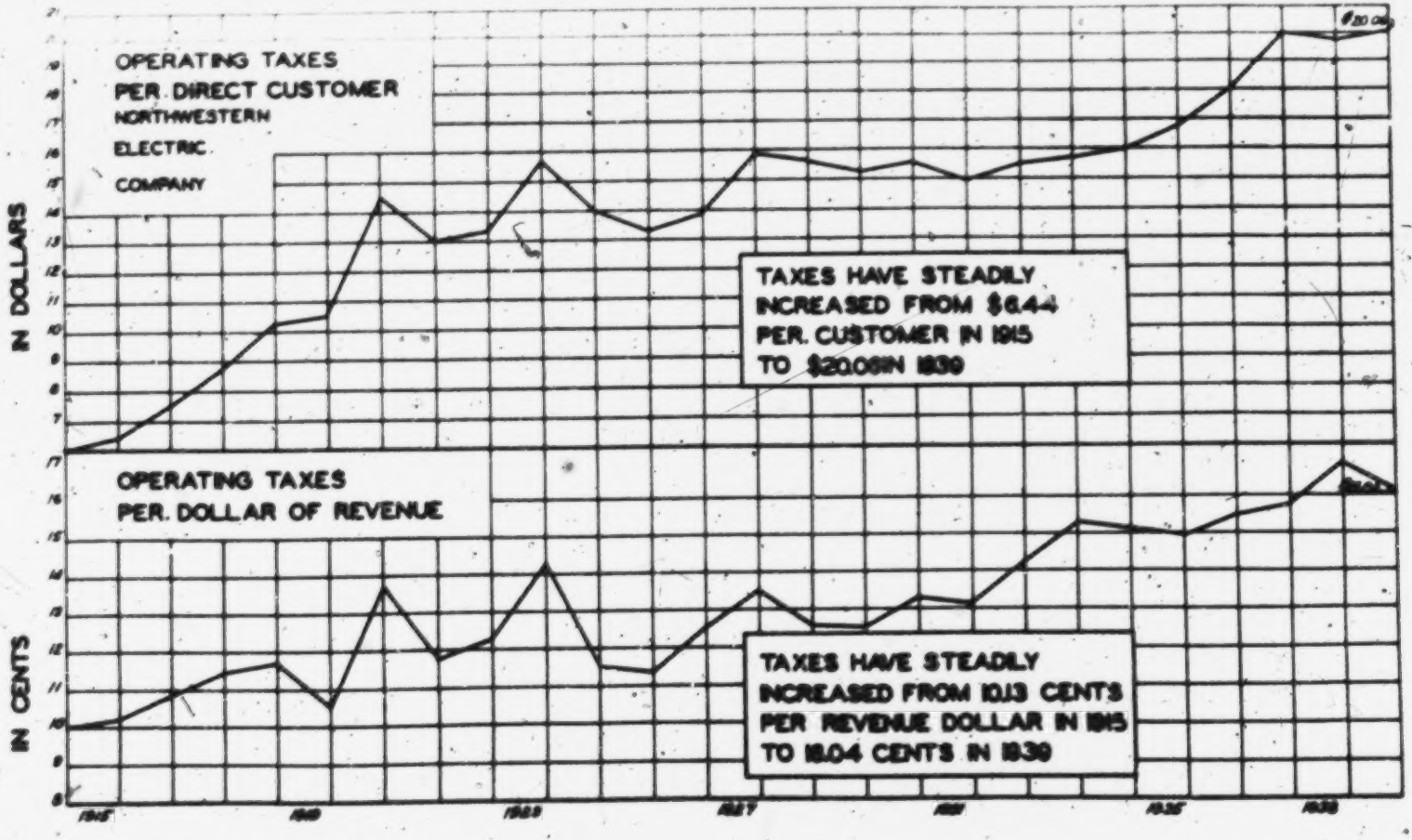

NUMBER OF DIRECT CONSUMERS
ENTIRE SYSTEM
BY RATE CLASSIFICATION
THIS DOES NOT INCLUDE DIRECT CONSUMERS
IN APARTMENTS AND BUILDINGS
NORTHWESTERN ELECTRIC COMPANY
RESIDENTIAL AND FARM
COMMERCIAL
POWER, GOV'T, MUNICIPAL

EXHIBIT "A"

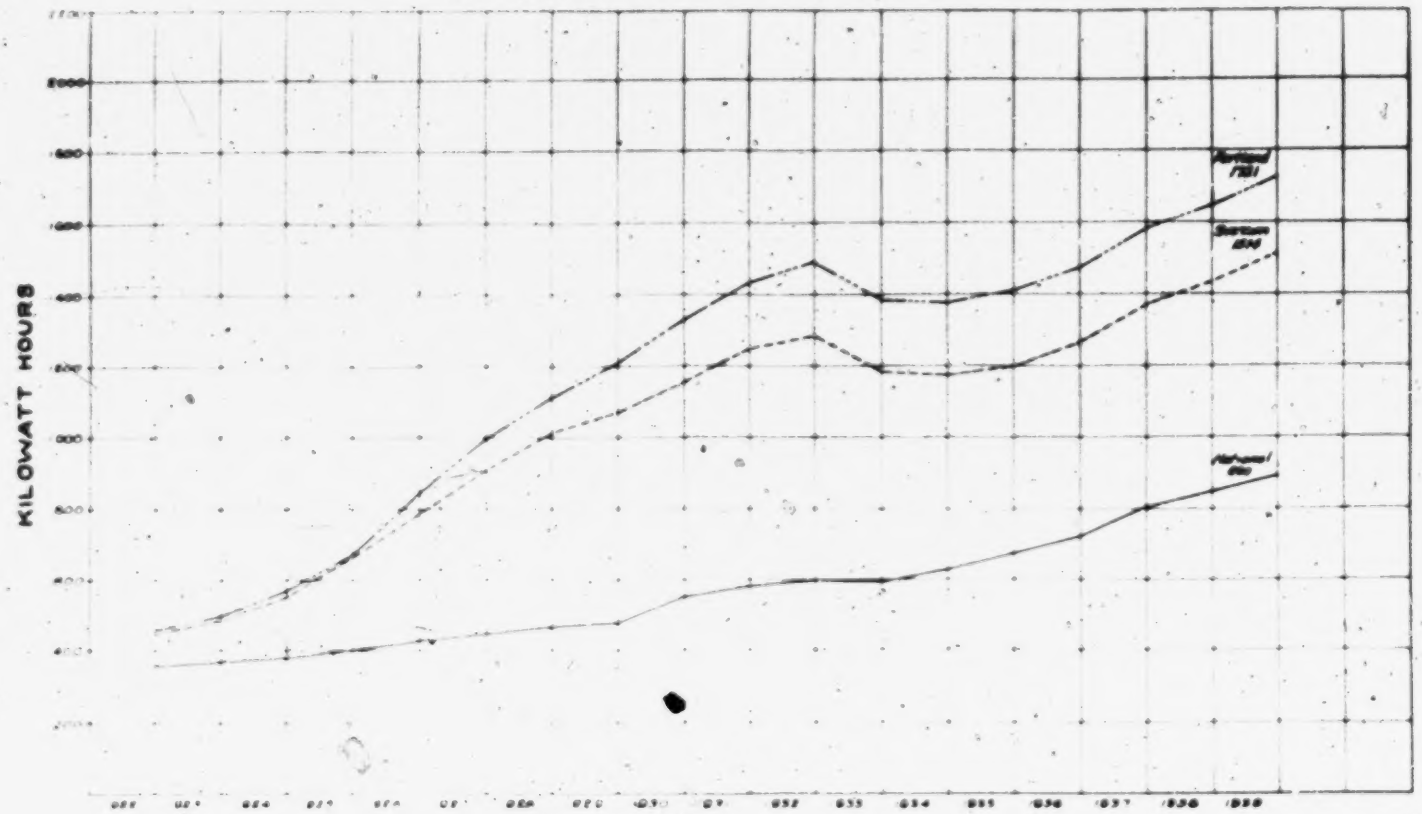

TAXES
CHARGED TO OPERATION
DOES NOT INCLUDE NON-OPERATING TAXES
TAKEN FROM MONTHLY FINANCIAL REPORT
TOTAL OPERATING TAXES
25 YEARS $[illegible],479
NORTHWESTERN ELECTRIC COMPANY

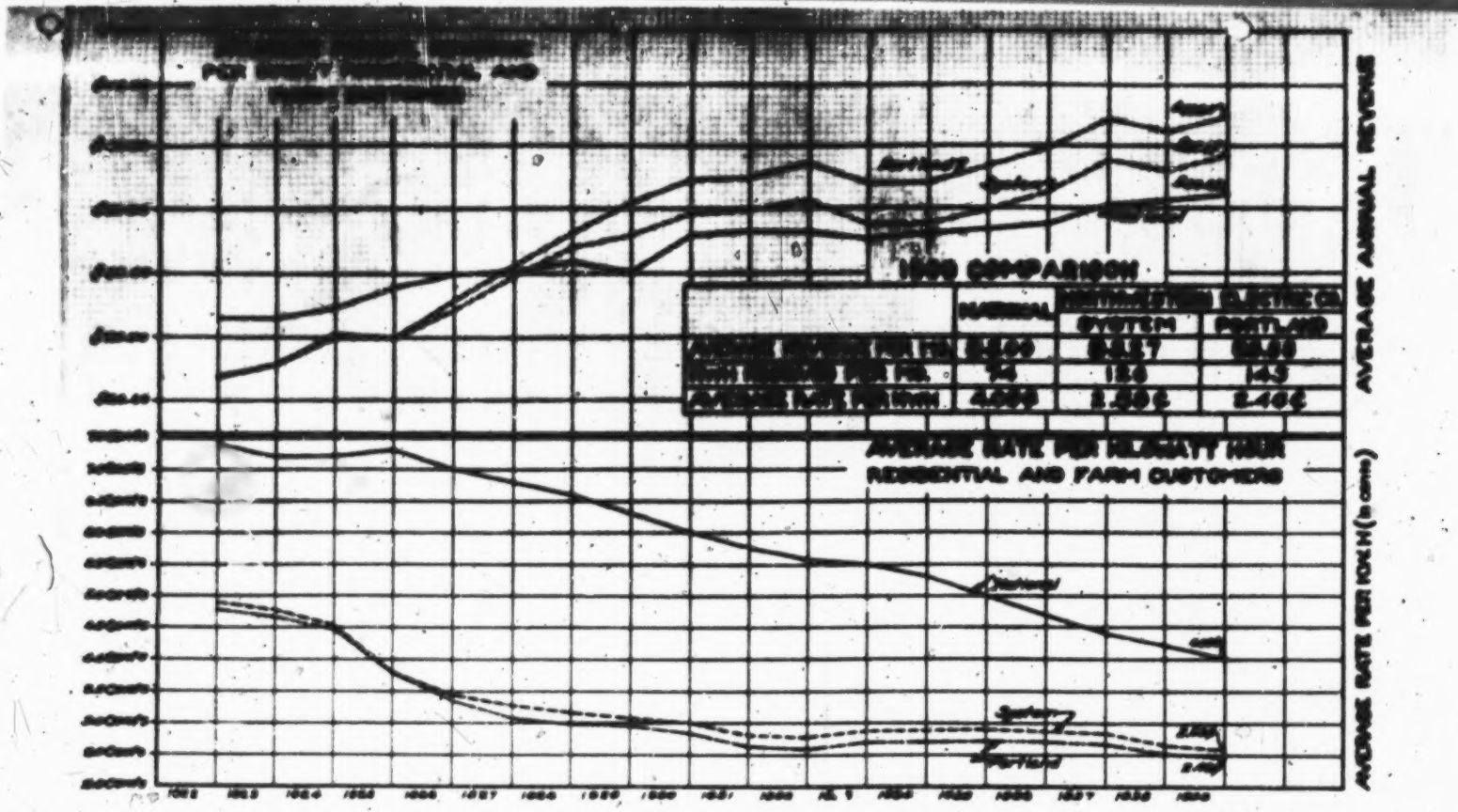


No figures for 1918 Change of fiscal year.

EXHIBIT "C"

AVERAGE KILOWATT HOURS PER YEAR PER DIRECT RESIDENTIAL CONSUMER
NORTHWESTERN ELECTRIC COMPANY




1950 COMPARISON
AVERAGE RATE PER KILOWATT HOUR
RESIDENTIAL AND FARM CUSTOMERS
AVERAGE RATE PER KILOWATT HOUR (In cents)
AVERAGE ANNUAL REVENUE

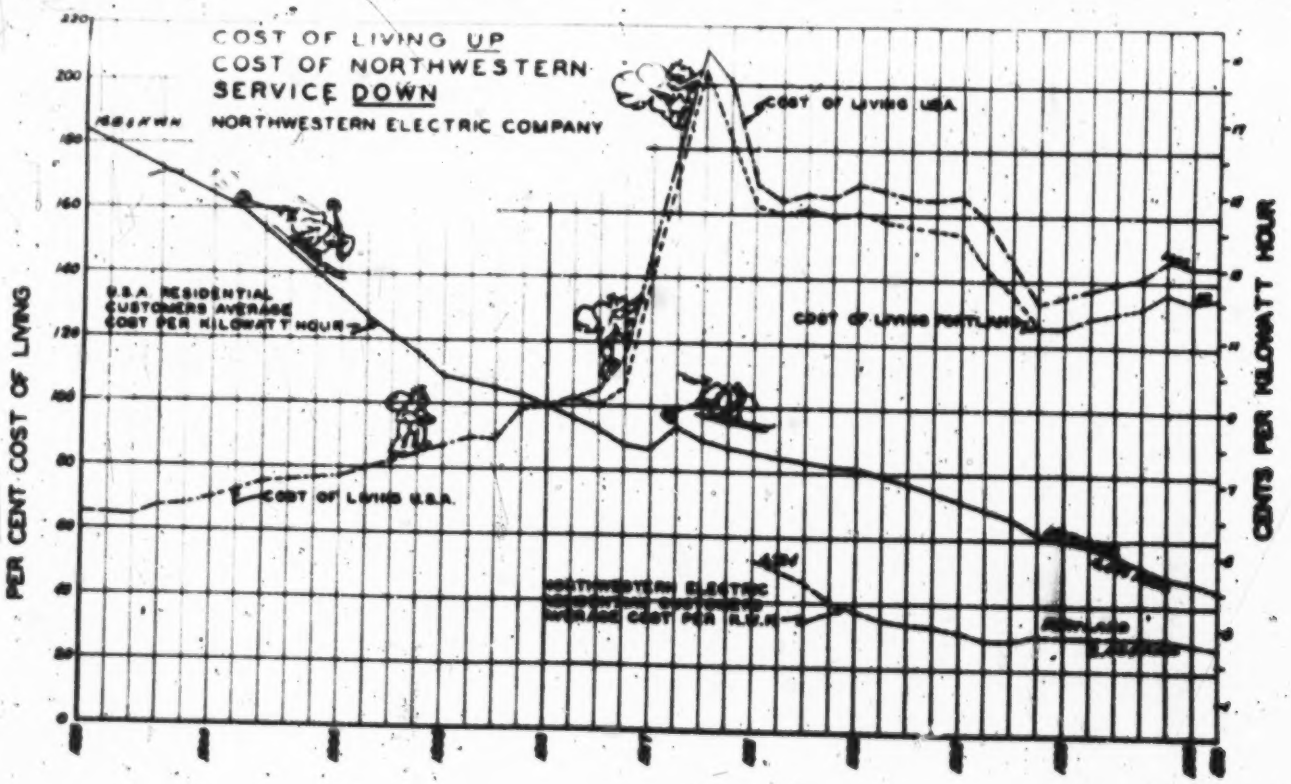

COST OF LIVING UP
COST OF NORTHWESTERN SERVICE DOWN
NORTHWESTERN ELECTRIC COMPANY
COST OF LIVING U.S.A.
U.S.A. RESIDENTIAL CUSTOMERS AVERAGE COST PER KILOWATT HOUR
COST OF LIVING U.S.A.
PER CENT COST OF LIVING
CENTS PER KILOWATT HOUR

EXHIBIT "F"

State of Oregon,
County of Multnomah—ss.

I, C. W. Platt, being first duly sworn, upon oath depose and say: I am Secretary and Treasurer of Northwestern Electric Company, the Respondent above named, and as such officer make this verification for and on behalf of said corporation; that I have read the foregoing Answer, know the contents thereof, and verily believe the same to be true.

C. W. PLATT

Subscribed and sworn to before me this 20th day of July, 1940.

[Seal] JEAN McGILCHRIST
Notary Public for Oregon

My commission expires: Aug. 2, 1940

United States of America
Federal Power Commission

Docket No. IT-5642

In the Matter of
NORTHWESTERN ELECTRIC COMPANY

OPINION NO. 56

Appearances

For Northwestern Electric Company:
Laing & Gray, by John A. Laing
and Henry S. Gray
Reid & Priest, by A. J. G. Priest
and Sidman I. Barber

For Public Utilities Commissioner of Oregon:
Alvin A. Kurtz, General Counsel

For Washington Department of Public Service:
Harry A. Bowen, Examiner

For the Federal Power Commission:
Richard J. Connor, Assistant General Counsel
George Slaff
Milford Springer

OPINION AND FINDINGS

This proceeding arises under Section 301(a) of the Federal Power Act and relates to the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Power Commission and the accounting entries which the Com-

pany proposed to enter in its books under certain requirements thereof.

History of the Case

Northwestern Electric Company was incorporated on January 7, 1911, in the State of Washington, and is engaged in interstate and intrastate commerce, producing, transmitting and distributing electrical energy to retail and wholesale customers in the States of Oregon and Washington. It also operates a central steam heating utility in Portland, Oregon.

The Federal Power Commission, pursuant to the authorization of the Federal Power Act, prescribed a Uniform System of Accounts for Public Utilities and Licensees which became effective on January 1, 1937.

Electric Plant Instruction 2-D of the System of Accounts requires the reclassification of the electric plant of Public Utilities and Licensees as of the effective date thereof and the submission to the Commission by January 1, 1939, of adjusting entries necessary to reflect the reclassification.[1] The Com-

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1. Electric Plant Instruction 2-D provides:

"Not later than 2 years after the effective date of this system of accounts, each utility shall have completed the studies necessary for reclassifying its electric plant as of the effective date of this system of accounts in accordance with the accounts prescribed herein and it shall submit to the Commission the entries it proposes to make to carry out the provisions of this instruction. It shall submit

mission entered a supplementary order on May 11, 1937, in which was set forth in considerable detail the information to be submitted in connection with the reclassification studies.

Pursuant to these requirements, Northwestern Electric Company submitted on May 27, 1939, a purported reclassification of its electric plant accounts as of January 1, 1937, including proposed adjusting entries. Under similar requirements of the Public Utilities Commissioner of Oregon, the Company filed an identical reclassification study with that Commissioner.

This Commission's staff, in cooperation with the staff of the Public Utilities Commissioner of Oregon, made a field investigation of the Company's reclassification study. A Joint Report on this investigation was prepared and served upon the Company with a written request that it adjust its proposed reclassification to conform therewith. This Commission's letter of transmittal, dated May 1, 1940, also contained a request for a plan of disposition of a $3,500,000 Common Stock item which was transferred in the Joint Report to Account 107, Electric Plant Adjustments.

The Company declined to make the adjustments

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also a comparative balance sheet showing the accounts and amounts appearing in its books as of the effective date of this system of accounts and the accounts and respective amounts as of the same date after the proposed entries shall have been made."

recommended in the Joint Report and failed to present a plan for disposing of the $3,500,000 item. On June 18, 1940, the Federal Power Commission ordered the Company to show cause, at a public hearing on July 15, 1940, at Portland, Oregon, why the Commission should not find and determine by order that adjusting entries be made to bring the books of account in conformity with the Joint Report.

Upon request of the Company, the date for hearing was postponed to July 22, 1940. On July 5, the Company filed an Application for continuance for a period of thirty days, which was denied by the Commission.

On July 17, 1940, the Company filed a Motion to Dismiss the proceedings, which Motion was denied. Thereafter, on July 22, 1940, the Company filed a voluntary Answer to the Show-Cause Order.

The public hearing was held at Portland, Oregon, commencing on July 22, 1940, and concluding on August 1, 1940. The Department of Public Service of Washington and the Public Utilities Commissioner of Oregon petitioned to intervene and the Commission granted these requests. Pursuant to the Order to Show Cause and Fixing Date for Hearing, a joint hearing was held in which the Public Utilities Commissioner of Oregon, the Honorable Ormond R. Bean, participated. The transcript of the proceedings totaled 1,179 pages and 78 exhibits were admitted in evidence. After the

hearing, briefs were filed by counsel for the Company and the Federal Power Commission.

Jurisdiction of the Federal Power Commission

The facts show, and the Company admits, that it owns and operates facilities used for the transmission of electric energy in interstate commerce and that it sells electric energy at wholesale in interstate commerce. It is, therefore, a "public utility" within the meaning of that term as used in Parts II and III of the Federal Power Act.

Authority of the Federal Power Commission Over Public Utility Accounting

The Company contends its general corporate and other fundamental accounts and records are not within the purview of Section 301(a) of the Federal Power Act, but, on the contrary, that the State regulatory authorities alone have comprehensive accounting and other supervision over its affairs. It argues that the correct interpretation of Sections 201(a) and (b) and 207 of the Act impel such conclusion. With this we are not in accord. The rule of statutory construction that specific provisions must prevail over general provisions is applicable in this instance. Section 301(a) authorizes this Commission to prescribe accounting rules and regulations; requires "every licensee and public utility" to keep its accounts, records, and books in accordance therewith, and provides "that nothing in this

Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State."[2] Carrying out

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2. Section 301(a) of the Federal Power Act provides:

"Every licensee and public utility shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this Act, including accounts, records, and memoranda of the generation, transmission, distribution, delivery, or sale of electric energy, the furnishing of services or facilities in connection therewith, and receipts and expenditures with respect to any of the foregoing: Provided, however, that nothing in this Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts, to be kept by licensees and public utilities and may classify such licensees and public utilities and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof."

its responsibility under this section, in an earnest effort to make effective the Congressional direction to establish uniformity in accounting in the electric field, the Commission has prescribed a Uniform System of Accounts. Obviously, Congress was cognizant of the fact that uniform and comprehensive accounting information is not only desirable but a vital prerequisite to effective regulation of interstate commerce.[3]

The Supreme Court of the United States has recognized that it would be impracticable for a Federal agency to limit accounting requirements to the interstate portion of a public utility's business when it is also engaged in intrastate business, thus:

> "The object of requiring such accounts to be kept in a uniform way and to be open to the

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3. See Senate Report No. 621, p. 53, 74th Cong., 1st Session (1935). See also H. R. Report No. 1318, pp. 30-31, 74th Cong., 1st Session (1935). In the Senate Report it is stated by the Committee on Interstate Commerce:

> "Section 301 requires * * * every public utility subject to the act to keep its accounts in the manner prescribed by the Commission; it thus takes a long step in the direction of the uniform accounting which is so essential in the electric industry. The authority of the Commission over the accounts of companies under its jurisdiction extends to the entire business of such companies, but there is an express provision that nothing in the act shall relieve any company from keeping such accounts as it is required to keep by a State commission or by any requirement of State law."

> inspection of the Commisison is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction. Further, the requiring of information concerning a business is not regulation of that business." I. C. C. v. Goodrich Transit Co., 224 U. S. 194, 211 (1912).

The Supreme Court has sustained the Federal Communication Commission's System of Accounts for interstate telephone utilities, which is similar in principle to the Federal Power Commission's System of Accounts for Public Utilities and Licensees. A. T. & T. Co. v. United States, 299 U. S. 232 (1936).

In view of the provisions of the Federal Power Act and the decisions of the United States Supreme Court, there can be no doubt about our authority to require the Company to keep general corporate and other fundamental accounts and records covering its entire electric utility business in conformance with the provisions of our System of Accounts. Re Northern States Power Co., F. P. C. Op. No. 21-B, 33 P. U. R. (N. S.) 279 (1940).

The Principal Problems

There are four principal problems for determination in this proceeding. Briefly stated, they are:

(1) Whether the Company may now reaccount for interest during construction and add to cost of plant amounts for interest during construction not previously charged;

(2) Whether the Company may now reaccount for the administrative and general expenses previously charged to operating expenses and add a part thereof to its recorded plant cost;

(3) Whether the amount of $3,500,000 or any part thereof may be included in the Company's Account 301, Organization;

(4) The disposition of amounts in Account 107, Electric Plant Adjustments.

The first two problems have certain features which are common in principle. It is claimed by the Company that the reclassification required by Electric Plant Instruction 2-D of our System of Accounts, is to be derived not by a reclassification of cost as recorded on the books of the Company, but rather by a reaccounting of past expenditures.

The reclassification required by Electric Plant Instruction 2-D is just what it purports to be, i. e., a reclassification and not a reaccounting.

The specific situation with respect to the general

and administrative expenses, now sought to be included as a part of cost of plant, is as follows: In the Company's purported reclassification it has added to its recorded cost of plant the sum of $408,419.82,[4] representing the amount which it now claims should have been charged to electric plant for administrative and general expenses allocable to construction during the years 1926 to 1936, inclusive. During this period a total of $899,109.84 was actually capitalized currently as administrative and general expenses applicable to electric plant. The amounts making up the total of $408,419.82 were regularly charged to operating expenses during those years.

With respect to interest during construction, the situation is that during the period beginning July 1, 1914, and ending December 31, 1925, the Company did not choose to capitalize all the interest during construction that might have been capitalized under the then controlling System of Accounts. It did capitalize interest during construction on certain major construction work done in 1918 and 1919. It has now recomputed interest during construction for the aforementioned period to a total of $31,389.87[5]

4. This amount was originally claimed as $780,922.75 in the Company's reclassification report filed with this Commission; subsequently it was reduced to $435,182.38 by Exhibit No. 11, and changed again by the Company's witness to $408,419.82.

5. This amount was originally $34,959.79 in the Company's reclassification report, but changed to $31,389.87 by the Company's witness.

and seeks to add this amount to the recorded cost of its utility plant. This computation of interest is based upon the theoretical use of the Company's own funds and does not represent identifiable interest costs.

The third problem embraces the $3,500,000 included by the Company in Account 301, Organization, in its reclassification report, which is the present par value of the 100,000 shares of Common Stock issued to the promoters of the enterprise. In the Joint Report this Common Stock amount was identified as a write-up of electric plant and transferred to Account 107, Electric Plant Adjustments, where it is subject to disposition as we may approve or direct.

The fourth problem relates to the disposition of the $3,500,000 item, and a preferred stock selling expense item.

The Claimed Addition of Interest During Construction

From 1911, when the Company was organized, to July 1, 1914, which was the date when regular operations were begun, the Company capitalized interest during construction on all of its construction expenditures. From the commencement of regular operations through 1925 the Company did not capitalize interest during construction except in connection with the construction of its Lincoln steam plant. Since 1925 the Company has capitalized in-

terest during construction.[6] It is evident that the Company exercised a deliberate policy of not charging to capital all the interest during construction that might have been charged during the period 1914-1925; that such choice represented the exercise of proper accounting discretion at that time; that such choice was not an accounting error; and that it would be improper to permit the Company now to add this item to the recorded cost of its property.

It is not denied that had such interest during construction been recorded as an element of cost at the time it was alleged to have been incurred, no question would now be raised as to its propriety. But this does not negate the principle that accounting records must not be impeached because of a change in the subsequent conception by accounting officials of the Company as to what constituted cost for a prior period.

The Company contends that inasmuch as the Commission's System of Accounts includes interest during construction as a component of construction cost, the failure to capitalize interest during construction in the past must be deemed to be "an accounting error", regardless of what may have been the policy of the management at the time of the transactions. It cannot be asserted that any "accounting error" was involved in the choice of

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6. That is, the Company has followed the plan of capitalizing interest on all projects costing more than $1,000 and requiring more than 30 days to construct.

previous management not to capitalize interest during construction on much of the construction during this period. Such a choice was within the field of managerial discretion. The deliberate choice not to record this allowable component of cost represented the manifestation of the management's considered policy.

The entire history of the Company's accounting practices with respect to the interest during construction shows the exercise of discretion by the management under the then controlling Systems of Accounts and the change from time to time in managerial policy. The practice of capitalizing interest on large projects, such as, the Lincoln steam plant, but ignoring it on small ones is not at all an unusual one or unique to this Company. Although the exercise of a different discretion might have been equally proper, there was nothing wrong in the manner in which the Company exercised its discretion with respect to capitalization of interest during construction during the period 1914-1925. There is no "accounting error" to be corrected at this time.

There is no fundamental accounting principle involved in the capitalization of interest on the Company's own funds or the policy of non-capitalization of interest in whole or in part. Public accountants have no hesitancy in certifying to financial statements of industrial enterprises or public utilities where, as a matter of accounting or financial policy of management, interest during construction is not capitalized or is capitalized only in part.

The Company's attempted reaccounting does not represent any reclassification of the Company's accounts. It is an attempt to construct a statement of cost of plant different from the recorded cost because of a change in the attitude of the Company as to what should have been charged as cost 15 to 25 years ago.

Despite the fact that Electric Plant Instruction 2-B of the Commission's System of Accounts does not definitely prohibit the restatement of interest during construction in this case as it prohibits the restatement of amounts previously charged to operating expenses, there is nothing in the System which sanctions such recomputation. To permit, at this time, a reaccounting of costs during the period 1914-1925 (because the Company now seeks to change its policy retroactively) would start us on the road to chaos in accounting.

We have carefully considered the evidence offered and the arguments presented by the Company. We are of the opinion that the proposed reaccounting for interest during construction not only does violence to the intent and purpose of the Commission's System of Accounts but is directly contrary to sound regulatory procedure. Any other conclusion would permit retroactive accounting for indefinite periods in the past. Today's accounting could be destroyed tomorrow, if such practices are condoned. Accounting carried out within the range of allowable discretion under controlling Systems of Accounts and not in conflict with fundamental accounting prin-

ciples should have an element of finality so that the regulatory process can function and the public, investors as well as consumers, be adequately protected. If we were to permit the reaccounting proposed by the Company in this respect, we would be encouraging instability and frequent shifting in utility accounting. Impeachment of past proper accounting will not be sanctioned and the integrity of accounts must be maintained.

The Company seeks to add to recorded cost additional amounts which it had previously decided in the exercise of its allowable discretion were not a part of cost of plant. We find this to be improper and contrary to the reclassification requirements of our System of Accounts.

Additional Administrative and General Expenses Claimed as Cost of Plant

As we have pointed out, the Company's attempted reaccounting would add to the recorded cost of plant the sum of $408,419.82, representing additional prorated general and administrative expenses for the years 1926 to 1936, inclusive. The amounts comprising this total were previously charged to operating expenses during this period. Such reasoning is specifically forbidden by Electric Plant Instruction 2-B of the System of Accounts, which reads:

> "It is * * * not intended that adjustments shall be made to record in electric plant accounts amounts previously charged to operating expenses in accordance with the uniform system of accounts in effect at the time or in accord-

ance with the discretion of management as exercised under such uniform system of accounts."

It is the contention of the Company that either the Commission did not mean what it said in the foregoing instruction or that if such were the intent, the Commission's Uniform System of Accounts in this respect is arbitrary and unreasonable. Under the Systems of Accounts generally in effect in the past for electric utilities, and also under the present System, utility officials have been and are permitted considerable discretion in accounting for certain joint and other costs which cannot clearly be classified as plant costs or operating expenses. This is particularly true as to those items which are subject to proration or allocation. See Section 3 of General Instructions and Definitions for Fixed Capital Accounts of the superseded Uniform Classification of Accounts for Electrical Utilities prescribed by the Public Service Commission of Oregon which became effective January 1, 1925.

It is undisputed that the Company exercised its allowable discretion in its past accounting. The Company states that its recorded book costs of plant do represent the accounting costs thereof, determined in accordance with what were then currently accepted principles of accounting. It further states that it is satisfied with its present recorded costs. The Company admits that there is no difference between the elements of cost as contained in

the applicable old and new Systems of Accounts. The Company contends that it should be permitted to recast its plant accounts because of the increased significance of original cost or prudent investment in utility regulation. To achieve this objective, it is willing to impeach its past financial statements submitted to regulatory agencies, taxing authorities, investors and other persons interested in its affairs. Its officers now wish to exercise anew the discretion properly exercised at the time, as to what constituted an operating or capital expenditure. They wish to exercise their discretion so as to show maximum charges to plant and minimum charges to income long after the income statements have served their purpose. The income account is fully as important as the plant account; under the scheme advocated by the Company great doubt would always be cast upon both.

The Company claims that the cost of public utility plant is a fact not at all dependent upon any accounting practices. We know that the cost of any utility plant is the resultant of the allowable accounting discretion of the utility as exercised within the limit permitted by the system of accounts, but the utility having exercised such allowable discretion is thereafter bound by the cost resulting therefrom. Many expenditures made by a utility must be assigned, allocated, or prorated on the basis of judgment, to the various plant and operating accounts. The cost of plant is dependent upon those assignments, allocations, and prorations, just as operating expenses are dependent thereon.

The Company would impeach its records of the past, although admitting they were kept in accordance with sound principles of accounting, by reassigning, re-allocating, and reprorating certain joint costs. It attempts to do so under the erroneous interpretation that this Commission's System of Accounts requires it. Our System of Accounts prohibits rather than requires such reaccounting. To provide otherwise would be to destroy the usefulness of the System of Accounts as a regulatory instrument.

When items are charged to expense in accordance with sound principles and practices of accounting, they should remain in expenses and the Commission will not tolerate their restatement in plant accounts with the natural concomitant of an additional charge to expense as depreciation. If such a restatement as urged by the Company in this case were sanctioned, managerial discretion in matters of accounting would have to be wholly circumscribed and precise, detail accounting prescribed for each item.

A recent decision by the Illinois Supreme Court, in the case of Peoples Gas Light & Coke Company, v. Slattery, 373 Ill. 31, 31 P. U. R. (N. S.) 193, 206 (1939), exposes the impropriety of that Company's similar attempt to capitalize administrative and general expenses which were formerly charged to operating expenses, thus:

> "The original cost new, as shown by the company of the other physical property, is $111,330,067.67. There is no opposing proof upon this

question. However, included in this amount is the sum of $1,957,753, of items which were charged to operating expenses. Most of the items were part of general expenses originally charged to operation and now allocated to construction. The inclusion of this item in cost of property in our opinion was error.

"The original cost of property for rate-making purposes may not be increased because of a change in the company's policy with respect to charge items as between operation and construction. Knoxville v. Knoxville Water Co. (1909), 212 U. S. 1, 53 L. Ed. 371, 29 S. Ct. 148. In Lindheimer v. Illinois Bell Teleph. Co., supra, where amounts charged to operating expenses and charged to depreciation reserve were too high, the Company was not permitted to show, in fact, that part of such expenses went into the capital structure, the court, at p. 348 of 3 PUR (NS), saying: '. . . if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.' In Wheeling v. Natural Gas Co. (1934), 115 W. Va. 149, 5 PUR (NS) 471, 175 SE 339, it is held that

where overhead items of physical property were charged to operating expenses, they could not be changed into the capital account for rate-making purposes, because, while such expenses were being so charged, the rates were undoubtedly fixed and based upon their being a part of regular expenses. It seems clear that it is not proper to build up operating expenses and get the advantage of a rate authorized to cover them, and later change the method of accounting to include such excess items as a part of the investment of the company, when, in reality, the money has been furnished by the customers of the Company. The original cost, to this extent, was excessive . . ."

The California Commission has enunciated the correct principle to be applied in this proceeding, in the case entitled Re Los Angeles Gas & Electric Corporation, P. U. R. 1933 E, 317, 323, as follows:

"* * * The vice of what the company has here sought to do lies in its attempt to give a RETROSPECTIVE effect to a change in policy where the relationships established under the superseded policy cannot all be effected consistently, for while capital is thus increased the benefit of lessened operating charges over the years cannot be extended retroactively to the company's consumers.

"What the company has here sought to accomplish is entirely wanting in equity. If

sanctioned, it would cast doubt and uncertainty upon the reliability of utility accounting developed over many years under public supervision. If fixed capital accounts may be thus surcharged now they may be revised again in the future. Ideas of overhead percentages vary widely and vary from time to time. The element of judgment enters into their determination. A variation of but one per cent in the amount of these involves a large amount in the total of fixed capital. Should capital accounts be thus subject to change, energetic and astute valuation and other experts would ever be combing over utility accounts and effecting changes and revisions in the permanent records and fixed capital accounts would become as variable and shifting as the ideas of those in charge. In the complicated processes of regulation, involving not alone the fixation of rates but the supervision of security issues, it is highly important that permanent accounting records maintain a continuity and import a reliability which would not exist if subject to revision and change whenever new faces appeared in positions of influence in the management."

In numerous other cases Courts and Commissions have considered it improper for public utilities to capitalize retroactively items which have been charged by election of management to operating

expenses in the past.[7] The Committee on Statistics and Accounts of the National Association of Railroad and Utilities Commissioners in its September 20, 1940, "Statement Relating to the Original Cost and Reclassification of Utility Plant Pursuant to the Provisions of Uniform Systems of Accounts," (like our System) is in complete agreement with our conclusions on this subject.

We find that the Company's attempt to add to plant costs administrative and general expenses pre-

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7. Los Angeles Gas & Electric Company v. Railroad Commission, 58 Fed. (2d) 256, 260, P. U. R. 1932 C, 397, 404 (D. C., S. D., Calif. 1932); Natural Gas Company v. Public Service Commission, 95 W. Va. 557, 121 S. E. 716, P. U. R. 1924 D, 346 (W. Va., S. Ct. App. 1924); Plainfield-Union Water Company v. Board of Public Utility Commissioners of New Jersey, 140 Atl. 785, 786, P. U. R. 1928 C, 657, 660 (N. J., S. Ct. 1928); Elgin, Joliet & Eastern Railway Company, 84 I. C. C. 587, 592 (1924); Re Potomac Electric Power Company, P. U. R. 1917 D, 563, 604 (D. C. P. U. Comm. 1917); Re Central Maine Power Company, P. U. R. 1918 C, 792, 796 (Maine P. U. Comm., 1918); Re Indianapolis Water Company, P. U. R. 1919 A, 448, 470 (Ind. P. S. Comm., 1918); Re Eaton Rapids, P. U. R. 1922 D, 94, 103 (Mich. P. U. Comm., 1922); Re Kootenai Power Company, P. U. R. 1924 E, 831, 833 (Idaho P. U. Comm., 1924); Re Mondovi Telephone Company, P. U. R. 1933 B, 319, 321 (Wis. P. S. Comm., 1932); Re Yonkers Electric Light & Power Company, 6 P. U. R. (N. S.) 132, 147 (N. Y. Dept. P. S., 1934); Illinois Commerce Commission v. Commonwealth Edison Company, 15 P. U. R. (N. S.) 404, 405 (Ill. Commerce Comm., 1936); Re Hawaiian Electric Co., Ltd., 33 P. U. R. (N. S.) 161, 165 (Haw. P. S. Comm., 1940).

viously assigned to operations, not only violates the Commission's System of Accounts, and fails to conform to sound principles of accounting, but likewise vitiates the principles of equity in relation to its consumers. The claimed additional administrative and general costs are therefore disallowed.

Transfer of $3,500,000 from Account 301, Organization, to Account 107, Electric Plant Adjustments.

The Northwestern Electric Company was promoted by two financiers from San Francisco, California, who were interested in a paper mill on the Columbia River east of Portland, Oregon. The promoters desired a water power site to develop electricity for the paper mill. The Company was incorporated on January 7, 1911, and the promoters advanced about $175,000 to their agents to acquire power sites. On May 13, 1912, that money, with six per cent interest, was repaid by Northwestern Electric Company to the promoters.

The Company decided to enter the utility business in Portland and vicinity to utilize the power developed in excess of the paper mill's requirements. That the two promoters organized and controlled the Company is undisputed. On May 14, 1911, the promoters had the Board of Trustees of Northwestern Electric Company issue 50,000 shares of Common Stock to them or their nominees. On May 14, 1912, the promoters caused the Trustees to increase the capital stock from 50,000 shares of

$100 par value to 100,000 shares of that par value, and to issue the additional shares to them or their nominees. The issue of the Common Stock was a disguised gift by the promoters to themselves.

This $10,000,000 of Common Stock was not recorded on the Company's books until January 31, 1914, when a charge was made to Construction and a credit made to Common Capital Stock. Although the Company did not receive any land or water rights for its Common Stock, the $10,000,000 was entered in the plant ledger account entitled Land and Water Rights. This entry was predicated upon the adoption of resolutions by the Board of Trustees that lands and rights were received by the Company for its Common Stock. The Company's first report to the Oregon Commission, for the year ended June 30, 1914, included this $10,000,000 in the balance sheet account entitled Cost of Plant and Equipment Prior to July 1, 1914. This amount remained in Northwestern Electric Company's reports to the Oregon and Washington Commissions as a part of the Company's Landed Fixed Capital until 1932. The Company now concedes that none of the foregoing accounting entries was in conformity with the facts.

In 1933, the Company transferred as of December 31, 1932, $9,600,000 to Miscellaneous Non-Operating Intangible Capital, and $400,000 to the fixed capital account entitled Organization. This transfer was related to the testimony of the Company's present

Secretary and Chief Accounting Officer before the Oregon Commission in a rate case, in which he stated that the Common Stock had a value of $400,000 as of July 1, 1914, based upon the cash value of the two promoters' services to the Company. The Public Utilities Commissioner of Oregon did not accept this valuation.[8]

On September 16, 1936, the Company decreased the Common Stock par value from $100 to $35 a share, which reduced the book value by $6,500,000.

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8. The Public Utilities Commissioner of Oregon stated on page 8 of P. U. C. Oregon Order No. 2228: (Ex. 76)

> "With respect to the item of $400,000.00, it is a purely theoretical estimate of the value, in excess of compensation received, of the services said to have been rendered by Messrs. Fleishhacker to the company before and for several years following its organization in 1911. It was made up by Mr. Platt, secretary of the company, in 1933. Mr. Platt entered the employ of the company in 1925, many years after the alleged services were rendered. The Fleishhackers made no charge to the company for these services and nothing was charged to fixed capital or operating expense therefor, either in the time the Fleishhackers were in control of the company up to 1924 or thereafter, until 1933, when the theory was advanced that a value of $400,000 should be put on these alleged services and this amount included in operating fixed capital. The testimony in support of this item is obviously too speculative and conjectural to justify its inclusion in operating fixed capital, and it is therefore eliminated therefrom and should be expunged from the books."

This $6,500,000 was credited to the $9,600,000 in the account, Miscellaneous Non-Operating Intangible Capital, leaving $3,100,000 in that account, and $400,000 in the Organization account.

As of December 31, 1936, $300,000 was transferred from the Organization account to Miscellaneous Non-Operating Intangible Capital, so that immediately prior to this Commission's required reclassification $100,000 remained in the Organization account and $3,400,000 in the Miscellaneous Non-Operating Intangible Capital Account.

In the Company's purported reclassification of electric plant accounts, which it filed with this Commission, the $3,400,000 in the Miscellaneous Non-Operating Intangible Capital account was transferred to Account 301, Organization, making a total of $3,500,000 par value of Common Stock in that account.

The Company's Chief Accounting Officer attempted to support his estimate of $3,500,000 as the cash value of the 100,000 shares of Common Stock as of July 1, 1914. He employed three indexes of value. One index was the value of $22.50 a share for the 100,000 shares as of March 1, 1913, which was employed in 1934 as a basis for an income tax settlement by one of the promoters. Another index was the high quotation on the San Francisco Stock Exchange for this stock in 1916 of $25.50 a share. The third index was the price of approximately $50 a share paid in 1925 for the outstanding Common

Stock by American Light & Power Company to obtain sole ownership. From all this, the Company's witness conjured $3,500,000 as his estimate of the cash value of the 100,000 shares of Common Stock as of July 1, 1914. This judgment estimate is without probative value because it is not based upon the value of the consideration received by the Company at the time the Common Stock was issued, and there is no reliable evidence in the record that any promoters' services of demonstrable value or any other consideration was received by the Company for its Common Stock.

The real cost of all the property of the Company at the time of the issuance of its Common Stock was represented by debt securities. This condition likewise prevailed on July 1, 1914, except for a small amount of Preferred Stock. Even today the Company's entire Common Stock is not represented by any assets received by the Company in exchange for it. No electric plant was received in exchange for the Common Stock; hence, no amount in respect thereof should remain in the electric plant accounts. The issuance of this stock was manipulation.

From the foregoing, we find that the $3,500,000 item is a write-up and was properly transferred to Account 107, Electric Plant Adjustments, in the Joint Report and it should be entered in that account until disposed of as we shall direct.

Accounting Adjustments Conceded by the Company

Interest on Average Cash Balances and Interest and Taxes on Construction Material Inventories

Northwestern Electric Company, in its reclassification report, attempted to add to the existing cost of plant as of December 31, 1936, an amount representing interest on average annual cash balances. To determine this theoretical element of original cost of utility plant, the Company made a complex computation based upon the claim that for twenty-three years it maintained cash balances available for construction and that it was entitled to capitalize six per cent interest on the average amount thereof for each of the years. Of the total amount claimed, $31,443.45 was prorated to the primary utility plant accounts in Account 100.1, Electric Plant in Service, and the remainder, amounting to $2,772.68, was prorated to the primary accounts in Account 108, Other Utility Plant (Steam Heating).

As a theoretical component of original cost of utility plant, the Company, in its reclassification study, claimed an addition to the cost of plant, as of December 31, 1936, of a large amount representing estimated interest and taxes on estimated construction material inventories for a period of twenty-one years. Of the total estimated interest and taxes, $238,220.52 was prorated to the primary accounts in Account 100.1, Electric Plant in Service, and the remainder, $34,198.72, prorated to Account 108, Other Utility Plant (Steam Heating).

Cash funds, and material and supply inventories, available for the purposes of operation or construction, constitute components of working capital. It is not good practice to capitalize estimated carrying charges on working capital. The Company now concedes the impropriety of the claimed adjustments and we hold the amounts thereof must be disallowed. We find that in the Joint Report the entire amounts of interest on average cash balances and interest and taxes on construction material inventories were properly transferred to Account 107, Electric Plant Adjustments. This transfer effects a cancellation of the proposed restatement.

Jointly Used Property Transferred to Common Utility Plant Account

In the Company's reclassification study, only the costs of those facilities used for transmission and distribution of steam were entered in Account 108, Other Utility Plant (Steam Heating). The Company placed the cost of all production and general facilities used jointly by the steam heating and electric departments in Account 100.1, Electric Plant in Service.

In the Joint Report a total of $4,426,886.24 of jointly used facilities was properly transferred from Account 100.1, Electric Plant in Service, to the detailed plant accounts under Account 108, Other Utility Plant (Common). The Company concedes and we find that adjustment of its jointly used property to be proper.

Electric Plant Held for Future Use

The Company's reclassification report contained in Account 352, Station Equipment, the cost ($6,612.92) of equipment in the Taylor Street substation which was not in service, but was held for future use. In the Joint Report this item was transferred to Account 100.4, Electric Plant Held for Future Use. We find this adjustment to be proper. The Company conceded the adjustment of this item, but claimed that there should be added certain restated overheads, which we have already found to be improper.

Transfers Within Account 100.1, Electric Plant in Service

In the Joint Report the cost of steel towers and fixtures on the Albina-Lincoln and Camas-Albina transmission lines was transferred from Account 345, Poles and Fixtures, to Account 344, Towers and Fixtures. We find this adjustment to be proper. The Company conceded this adjustment, but claimed that certain restated overheads should be added, which we have already found to be improper.

Disposition of Amounts in Account 107, Electric Plant Adjustments

$3,500,000 Write-up

The Company contends that it did not have notice that the disposition of any amounts reclassified in the Joint Report in Account 107, Electric Plant

Adjustments, would be considered in this proceeding. This contention of the Company is without merit. The evidence clearly shows that the Company fully understood prior to the hearing that the question of disposition was an issue. It was not until near the conclusion of the hearing, and after one of the Commission's witnesses had testified without objection on the subject and had been cross-examined, that the Company made the contention that the question of disposition was not included within the scope of the hearing.

The Company further contends it was not given the details of the proposed disposition either before, after or during the course of the hearing and was afforded no opportunity to submit evidence and argument thereon. This contention is unfounded, as is shown by the record in this proceeding. Witnesses for the Commission made definite recommendations relative to the disposition of the unsupported amount of $3,500,000. Every opportunity was given the Company to submit evidence, to cross-examine the Commission's witnesses and to present argument on the subject. The Company cannot now complain that it did not receive a fair hearing merely because it did not choose to submit evidence, offer a plan of disposition, or argue the cause.

As early as August 17, 1939, the Commission corresponded with the Company and notified it that its three items of $3,500,000 for Common Stock,

suance was not less than the sum of $3,500,000;

(6) That the Company, in its said reclassification of its accounts, properly included in Account 301, Organization, the sum of $3,500,000 carried on its present books of account as representing the par value of Common Stock issued to the organizers of the Company for their services in organizing the enterprise and putting it in readiness to do business.

B. Conclusions of law:

(a) The reclassification of electric plant pursuant to Electric Plant Instruction 2-D of the Commission's said System of Accounts is not an ascertainment of the actual legitimate cost of property, in accordance with the provisions of Section 208(a) of the Federal Power Act.

(b) The reclassification of electric plant pursuant to said Electric Plant Instruction 2-D of said System of Accounts requires the redetermination of the overall cost of the electric plant of the accounting utility and the adjustment, for the purposes of said System of Accounts, by exclusion or addition of amounts not recorded in accordance with the provisions of said System of Accounts with respect to retirements, capital stock expense, capitalization of overheads and other items.

includes structures, equipment and other items which are employed in the operations of the Company and are not assignable as between generation, distribution and transmission facilities except on the basis of an apportionment) comprises facilities used for the generation of electric energy, facilities used in local distribution and facilities used for the transmission of electric energy. More that 88% of such facilities (on the basis of their cost) are used for the generation of electric energy or in the local distribution thereof (Ex. No. 1, Statement F; Ex. No. 3, pp. 10-13);

(3) That $31,389.87 represents interest during construction at the rate of 6% per annum not previously capitalized on actual construction costs of the Company incurred during the period from July 1, 1914 to December 31, 1925;

(4) That the Company properly included in the reclassification of its accounts filed pursuant to the Commission's Uniform System of Accounts for Public Utilities and Licensees the restatement of $31,389.87 representing interest during construction for the period from July 1, 1914 to December 31, 1925;

(5) That the cash value of the Common Stock of the Company at the time of its is-

(4) is not supported by substantial or any evidence and is therefore arbitrary and capricious;

(5) requires the writing-off on the Company's books of account of values inherent in recorded costs of its property and thereby violates Article V of the Amendments to the Constitution of the United States in that it deprives the Company of its property without due process of law and takes its property for public use without just compensation; and

(6) denies both to the Company and to the holder of its common stock the "rudimentary requirements of fair play."

VIII. The Commission erred in failing to make and enter the following findings of fact and conclusions of law specifically requested at pages 51 to 54 of the "Brief for Company" and at page 33 of the "Reply Brief for Company":

A. Findings of fact:

(1) That the Company is subject to comprehensive regulation by the States of Washington and Oregon as to rates, adequacy of service, issuance of securities, accounting, contracts with affiliated interests and all other aspects of its business which concern the general public of such states;

(2) That the tangible electric plant of the Company (other than general plant, which

Driscoll v. Edison Light & Power Company, 307 U. S. 104 and enforced by the decisions of the Supreme Courts of Oregon and Washington.

The Company did not understand or interpret the Commission's show-cause order dated June 18, 1940 as having put in issue in this proceeding the disposition of amounts ultimately to be recorded in said Account 107. Furthermore, the notice given by said show-cause order, which was not served upon the Company until July 1, 1940, would not, in any event, have been adequate to permit the Company to assemble and prepare the evidence requisite to an appropriate factual presentation, as will more fully appear from the affidavit of C. W. Platt, the Secretary and Treasurer of the Company, hereto attached and by reference made a part hereof.

VII. The disposition of said amount of $3,500,000 so required by the Commission:

(1) was ordered without notice and hearing;

(2) represents the purported exercise of powers which are not granted to the Commission by the Act;

(3) invades powers reserved to the States by the provisions of the Act and by Article X of the Amendments to the Constitution of the United States;

(1) as to the appropriateness, and probable effect upon the interests of investors and consumers, of any plan or program for the disposal of any amount in Account 107 which may then have been recommended to the Commission;

(2) as to the power of the Commission (even for the purposes of the separate or memorandum system of accounts which the Company may be directed to maintain in order that the Commission may exercise its limited regulatory functions with respect to public utility companies) to direct that an amount or amounts either in Account 107 or any other account be written off or otherwise disposed of;

(3) as to the power of the Commission to exercise any regulatory authority whatever over the payment of dividends on the stock of the Company, such authority—so far as Northwestern Electric Company, a subsidiary of a registered holding company, is concerned—having been delegated, so far as any possible Federal control is concerned, to the Securities and Exchange Commission (Public Utility Holding Company Act, Section 12(c)) rather than to this Commission; and

(4) as to the effect of the "fair value" rule established by the Supreme Court of the United States in an unbroken line of decisions from Smyth v. Ames, 169 U. S. 466, to

pany's existing balance sheet and security structure, including (i) its Preferred and Common Stock and (ii) its First Mortgage Bonds and Debentures issued pursuant to an order of the Securities and Exchange Commission entered on October 19, 1939;

(2) The value of the property and assets of the Company in 1925, when its Common Stock was acquired by American Power & Light Company, the present owner of such Common Stock, including evidence as to the value inherent in the properties of the Company at that date;

(3) The adverse effect on the Company's credit standing and upon the interests of the holders of all of its securities of the accounting entries required by the Commission's Order to be made upon the Company's books, particularly including the required disposition of amounts recorded in Account 107, Electric Plant Adjustments, which requirement implies that the value of the Company's Common Stock is substantially less than the figure at which such Common Stock is presently carried upon the Company's books of account; and

(4) Values inherent in the property of the Company as a successful going concern.

D. The Company also was without opportunity under the circumstances of said hearing to present proof and argument:

VI. The Commission erred in ordering any disposition of said $3,500,000 without regard to and consideration of (a) the value of the property and assets of the Company which presently support its existing security structure or (b) its present balance sheet generally.

A. The ordered disposition rests upon the assumption that all of said amount of $3,500,000 which now represents the common stock of the Company must be attributed to the electrical facilities, operations and values of the Company, without consideration of its non-electrical properties, operations and values, over which the Commission has no jurisdiction. Such an assumption does violence to the facts and is not supported by substantial or by any evidence.

B. The ordered disposition is based upon a mistake of law in that the Commission attempts retrospectively to apply the provisions of the Act and the regulatory powers therein granted. The Act does not provide for or authorize any such retrospective application and does not authorize an order to write off book capital which, at the time, is represented by assets of equivalent value.

C. The Company was without opportunity under the circumstances of the hearing in this proceeding to submit evidence or argument with respect to:

(1) The present fair value of the Company's property as fully supporting the Com-

of disposition was in issue in this proceeding. Such request for the submission of a plan of disposition may be considered to be the action of the Commission only if all actions of the Commission staff are to be so considered and the adoption of any such premise would compel the conclusion that the findings of the Joint Report must be considered to be the findings of the Commission, made prior to hearing and in pre-judgment of the case, without notice to the Company and without opportunity for the submission of evidence or the presentation of arguments on its behalf.

(5) The Company is a corporation organized and existing under the laws of the State of Washington and the courts of that state alone have jurisdiction to determine the validity of the issuance of the Company's common stock and the adequacy of the consideration received therefor or to take action to enforce payment of an allegedly unpaid stock subscription.

B. The said provision of the Order requiring such disposition of said amount of $3,500,000 is further invalid and in excess of the jurisdiction of the Commission in that there was a lack of proper parties and the Order would deprive the holder of the common stock of the Company of property and property rights in a proceeding wherein said holder is not a party and of which it did not have notice.

(3) The Commission's show-cause order dated June 18, 1940, does not include any direction or requirement that the Company submit a plan for the disposition of the amount proposed to be included in Account 107 or that it show cause why a disposition of this amount should not be ordered by the Commission.

(4) The request made upon the Company "to submit a plan for disposing of the amount of $3,500,000 as set forth on page 29 of the report under Account 107" contained in the lette dated May 1, 1940, transmitting the Joint Report, was not made either by the Commission or pursuant to or as a part of any order of the Commission and represents only the views and action of the Commission's staff prior to any action in the premises by the Commission itself; and the Commission has consistently and uniformly adhered to the practice of distinguishing the Commission from the Commission's staff and action taken by the Commission from action taken by the staff and has consistently and uniformly refused to be bound by the action of the staff. The said request for submission of a plan of disposition, a matter which could become relevant only *after* determination that such amount of $3,500,000, or any other amount, is properly includible in Account 107, did not constitute notice that the matter

should not be made "to bring the books of account in conformity with the" Joint Report of the examiners; and the only action and recommendation of such Joint Report with respect to this item was the transfer thereof to Account 107 to be retained in such account, pending the submission to the Commission of a plan for its disposition. The pro forma balance sheet included in such Joint Report and reflecting the adjustment proposed by the Commission staff and to which conformity was sought by the Commission, as evidenced by its show-cause order, showed such amount as retained in Account 107 after disposition of the issues presented by such Joint Report. The Company patently could not submit a plan for the disposition of any amount which might be so transferred to Account 107 until *after* determination (a) of the question whether any such transfer should be made and (b) of the amount, if any, which should be so transferred.

(2) The statements made in the Company's "Motion to Dismiss" and in its supporting brief, which are assumed by the Commission to recognize the issue of disposition, had reference only to the *character* of Account 107 and the question whether the Commission might properly order the transfer of any amount to such account.

either retaining or charging off such amount on the books of the Company) was in issue in this proceeding, (b) that "the evidence clearly shows that the Company fully understood prior to the hearing that the question of disposition was an issue", (c) that "every opportunity was given the Company to submit evidence, to cross-examine the Commission's witnesses and to present argument on the subject", (d) that "furthermore, in the Company's 'Motion to Dismiss', and in its supporting brief, it recognized that the disposition of amounts in Account 107, Electric Plant Adjustments, was an issue in this case", (e) that "The Provisions of Account 107 require the disposition of the amounts recorded in that account", (f) that the "Commission would be justified, as a matter of proper accounting, in ordering, under the provisions of Section 301(a) of the Federal Power Act, the immediate charging off of the amount in question," and (g) that "This disposition, assuming adequate earnings, is the equivalent of obtaining ultimately from the holders of the common stock (the holding company) a consideration of $3,500,000 for the stock." The Company assigns each of such findings or conclusions as error.

(1) The Commission's show-cause order of June 18, 1940, which initiated this proceeding, required only that the Company appear and show cause why adjusting entries

ing out of the Commission's misconstruction of the statute under which it purports to act, in that it seeks to give a retroactive effect to the Act, particularly in imposing such burden of proof and (c) disregards the right of the Company to retain on its books of account values which are represented by present fair value, not subject to being written off as required by the Commission.

V. The Commission erred (i) in making its Finding that the amount of $3,500,000 representing the common stock now outstanding "should be disposed of by applying thereto all annual net income, after allowance for Preferred Stock dividend requirements, until the disposition of the entire amount has been accomplished," and (ii) in ordering that "For each year, commencing with the calendar year 1940, it [the Company] shall credit Account 107, Electric Plant Adjustments, and charge Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend appropriations for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished."

A. The opinion of the Commission rests such Finding and order upon the findings or conclusions: (a) that the matter of the disposition of the foregoing amounts (the word "disposition" apparently is interpreted to include

spect is contrary to the provisions of the system of accounts and, in particular, the requirements that, in such circumstances as those here under consideration, "when the consideration *given* for property is other than cash," the value of such consideration (*i.e.* the common stock) must be determined "on a cash basis" and "'Cost' means the * * * cash value at the time of the transaction of any consideration other than money." (Instructions—Electric Plant Accounts 3D; Definition 10.) (Emphasis ours.) A requirement that the Company furnish full and detailed accounting support for transactions occurring more than twenty-five years prior to the hearing in this proceeding and as to which the Company obviously was not under obligation to retain any such detailed accounting support or, in the alternative, charge off on its books the amounts recorded to reflect such transactions, imposes upon the Company both an unreasonable and an impossible burden of proof.

B. With respect to this Organization Expense item, the Order is (a) arbitrary in that it is not supported by substantial evidence, disregards substantial evidence of the value of the consideration given and attempts to impose upon the Company an impossible burden of proof, (b) based upon a mistake of law, aris-

A. The opinion of the Commission finds or concludes that the determination made by the Company of the cost to it of the electric plant for which common stock was issued in payment "is without probative value because it is not based upon the value of the consideration received by the Company at the time the Common Stock was issued and there is no reliable evidence in the record that any promoters' services of demonstrable value or any other consideration was received by the Company for its Common Stock" and that the "real cost of all the property of the Company at the time of the issuance of its Common Stock was represented by debt securities," and at this time "is not represented by any assets received by the Company in exchange for it." Each of such findings or conclusions is assigned as error.

Said findings or conclusions disregard the evidence submitted by the Company with respect to the services rendered by the persons receiving such stock (a) in the promotion of the Company, (b) in directing and managing its affairs, (c) in selling its preferred stock without other compensation, (d) in loaning their credit to the Company and (e) generally in putting the Company in "readiness to do business"; and said findings and conclusions are not supported by substantial evidence. The Commission's holding in this re-

the Company actually has done. In its reclassification study, the Company, on the one hand, *debited* these administrative and general costs to Account 100.1 for the purpose of disclosing actual original cost as required by the Commission's system of accounts and, on the other hand, *credited* such costs to Account 107, Electric Plant Adjustments. Utility Plant, in the aggregate, was not affected at all, since the debit to Account 100.1 was offset by the credit to Account 107. *No income or other accounts have been or are proposed to be affected by this transaction.* The Company has not proposed and does not propose to transfer to surplus any credit balance in Account 107.

IV. The Commission erred in making its Findings (i) that the Company has not complied with the reclassification requirements of the Commission's Uniform System of Accounts in that it has included in Account 100.1, Electric Plant in Service, the amount of $3,500,000 as Organization Expense, (ii) that such amount represents a write-up of plant account in the amount of the Company's common stock presently outstanding and that such stock was issued without value having been received therefor, and (iii) that such amount should be included in Account 107, Electric Plant Adjustments, and erred in ordering the Company to enter on its book a "reclassification journal entry" which transfers said amount to said Account 107.

as an element in arriving at the fair value determination which the Commission must make and the inclusion of such costs is required in order to effect a uniform, fair and proper application of the system of accounts. The exclusion of such costs in any such determination is unreasonable, arbitrary and discriminatory and thus is without sanction of law.

(2) There are very real and substantial differences between the Commission's system of accounts and the system of accounts prescribed by the regulatory authorities of the States of Oregon and Washington under which the Company previously operated. For example, the Commission's system of accounts provides for the capitalization of the portion of the pay and expenses of the general officers and of administrative general expenses applicable to construction work. On the other hand, the previously effective system of accounts permits only capitalization of the salaries and expenses of the general officers of "an electric plant under construction".

(3) Again, the Commission's contention that the capitalization of such administrative and general costs would "impeach" records of the past and would result in "an additional charge to expense as depreciation" is based upon a fundamental misconception of what

restated interest during construction and restated administrative and general expense, were questioned as items constituting proper cost of utility plant. In that letter of August 17, 1939, the Company was notified that the amount of $3,500,000 was improperly included in Account 301, Organization, and that it should be carried in Account 107, Electric Plant Adjustments. It knew, therefore, that the three presently disputed items were questioned nearly a year before the date of the hearing.

By letter dated May 1, 1940, transmitting the Joint Report, the Company was "requested to submit a plan for disposing of the amount of $3,500,000 set forth on page 29 of the report under Account 107, Electric Plant Adjustments, and described as the par value of 100,000 shares of the common capital stock" of the Northwestern Electric Company. The Company has not submitted a plan of disposition.

It is manifest that the Company knew months in advance of the notice of hearing that if it failed to support the questioned $3,500,000 Common Stock item the amount would be subject to disposition pursuant to the provisions of Account 107, Electric Plant Adjustments. Furthermore, in the Company's "Motion to Dismiss", and in its supporting brief, it recognized that the disposition of amounts in Account 107, Electric Plant Adjustments, was an issue in this case.

The applicable provisions of Account 107, Electric Plant Adjustments, are:

"* * * Write-ups of electric plant prior to the effective date of this system of accounts shall be recorded herein.

"B. The amounts included in this account shall be classified in such manner as to show the nature of each amount included herein and shall be disposed of as the Commission may approve or direct."

The Provisions of Account 107 require the disposition of the amounts recorded in that account. The Commission would be justified, as a matter of proper accounting, in ordering, under the provisions of Section 301(a) of the Federal Power Act, the immediate charging off of the amount in question. After considering the financial history and present status of the Company, as reflected in reports to stockholders and to this Commission, we are of the opinion that we should not order the amount to be charged off at once.

The Securities and Exchange Commission, in its order[9] dated October 19, 1939, placed restrictions on the payment of dividends on the Company's stock. Under these restrictions, dividends are prohibited on Common and Preferred Stock, unless the Company expends or accrues for maintenance and depreciation an amount equivalent to fifteen per cent of the Company's gross operating revenues received from October 1, 1939, to the date of the

9. Holding Company Act Release No. 1760.

proposed dividend payment. In addition, dividends on the Company's Common stock may be paid only from earnings accrued subsequent to September 30, 1939. This latter restriction has the effect of impounding the Company's earned surplus of $983,160.45 as of that date.

Considering all relevant factors, we find that it is in the interest of consumers, investors and the public to direct the disposition of the $3,500,000 write-up by requiring the Company to apply all net income above Preferred Stock dividend requirements to the disposition of the $3,500,000 in Account 107. This disposition, assuming adequate earnings, is the equivalent of obtaining ultimately from the holders of the common stock (the holding company) a consideration of $3,500,000 for the stock. Certainly dividends should not be paid on the Common Stock until it has the equivalent of a paid-in value.

Preferred Stock Selling Expense

The Company reported in Account 107, $243,953.47, representing expenses incurred in connection with the sale of its Preferred Stock. In the Joint Report the staffs recommended that the Preferred Stock selling expense be transferred to Account 151, Capital Stock Expense. Our System of Accounts provides that this account "shall include all expenses incurred in connection with the issuance and sale of capital stock which are not properly chargeable to electric plant account 301, Organiza-

tion, and which have not been charged to Account 414, Miscellaneous Debits to Surplus." We find that the Company's Preferred Stock selling expense is properly includible in Account 151, Capital Stock Expense.

Notwithstanding the Company's afterthought-contention that the disposition of the amounts in Account 107 was not an issue in this proceeding, the Company by letter dated May 31, 1940, concurred in the disposition of the foregoing $243,953.47, as recommended in the Joint Report.

Miscellaneous Items Erroneously Charged to Electric Plant and Reclassified in Account 107 by the Company

In the Company's reclassification study it found that amounts totalling $77.27 had been erroneously charged to the transmission land account. To correct these accounting errors the Company properly transferred those amounts to Account 107, Electric Plant Adjustments.

In the Joint Report the staffs recommended that the $77.27 be charged to Account 271, Earned Surplus. In the Company's letter of May 31, 1940, acknowledging receipt of the Joint Report, it contends that the $77.27 should be disposed of by considering it a "delayed item" and transferring it to operating expenses in conformity with General Instruction 6 of the System of Accounts. The amounts constituting the $77.27 are not "delayed items" as defined in the System of Accounts, but genuine ac-

counting errors. We find, therefore, that the proper disposition of the $77.27 is a transfer of that amount from Account 107 to Account 271, Earned Surplus.

FINDINGS

Based upon the evidence in this case, we make the following findings of fact:

1. Northwestern Electric Company owns and operates facilities for the transmission of electric energy in interstate commerce and for the sale of electric energy at wholesale in interstate commerce, is engaged in the business of such transmission and sale, and is, therefore, a public utility subject to the jurisdiction of this Commission within the meaning of the Federal Power Act;

2. The Company has not complied with the reclassification requirements of this Commission's Uniform System of Accounts in that it has erroneously included in Account 100.1, Electric Plant in Service: (a) the amount of $408,419.82, representing a restatement in plant accounts of administrative and general expenses charged to expense in the years 1926 to 1936, inclusive; (b) the amount of $31,389.87, representing recomputation of interest during construction from 1914 through 1925; (c) the amount of $3,500,000, representing a write-up of the plant account equal to and associated with the amount of Common Stock outstanding, which stock was issued without value having

been received; (d) the amount of $31,443.45, representing assumed interest on average cash balances; and (e) the amount of $238,220.52, representing assumed interest and taxes on the average materials and supplies held for construction;

3. The cost ($4,426,886.24) of the Company's production and general facilities, which are jointly used in rendering electric and steam heating service, should be included in Account 108, Other Utility Plant (Common);

4. The cost ($6,612.92) of the Company's equipment, located in the Taylor Street substation, which is not presently in service, should be included in Account 100.4, Electric Plant Held for Future Use;

5. The cost ($77,169.90) of the Company's steel towers and fixtures on the Albina-Lincoln and Camas-Albina transmission lines should be included in Account 344, Towers and Fixtures;

6. The $3,500,000 write-up should be included in Account 107, and should be disposed of by applying thereto all annual net income, after allowance for Preferred Stock dividend requirements, until the disposition of the entire amount has been accomplished;

7. The Company's Preferred Stock selling expense in the amount of $243,953.47 should be included in Account 151, Capital Stock Expense;

8. Miscellaneous items totalling $77.27, which the Company erroneously charged to electric plant, should be charged to Account 271, Earned Surplus.

An appropriate order requiring the Northwestern Electric Company to adjust its books of account to conform with our opinion and findings will be issued.

[Seal] LELAND OLDS,
Chairman.
CLAUDE L. DRAPER,
Commissioner.
BASIL MANLY,
Commissioner.
JOHN W. SCOTT,
Commissioner.
CLYDE L. SEAVEY,
Commissioner.

Dated at Washington, D. C. this 6th day of December, 1940.

[Signed] LEON M. FUQUAY
Secretary.

United States of America
Federal Power Commission

Commissioners—Leland Olds, Chairman, Claude L. Draper, Basil Manly, John W. Scott and Clyde L. Seavey.

December 6, 1940

Docket No. IT-5642

In the Matter of
NORTHWESTERN ELECTRIC COMPANY

ORDER DIRECTING ACCOUNTING ENTRIES IN RECLASSIFICATION AND DISPOSITION OF AMOUNTS IN ACCOUNT 107

Upon consideration of the previous orders in this proceeding, the evidence adduced of record, the briefs and other documents filed, and having on this date made and entered its Opinion No. 56 with Findings, which we incorporate by reference as a part hereof;

The Commission orders that:

(1) Northwestern Electric Company enter on its books not later than December 31, 1940, and as of December 31, 1936, the following reclassification journal entry:

	Debit	Credit
100. Electric Plant		
100.1 Electric Plant in Service		
Intangible Plant		
302. Franchises and Consents	$ 839.71	
Hydraulic Production Plant		
320. Land and Land Rights	152,491.07	
321. Structures and Improvements	243,573.03	
322. Reservoirs, Dams and Waterways	1,278,934.92	
323. Water Wheels, Turbines and Generators	99,280.06	
324. Accessory Electric Equipment	106,051.64	
325. Miscellaneous Power Plant Equipment	9,676.23	
326. Roads, Railroads and Bridges	30,431.99	
Transmission Plant		
340. Land and Land Rights	159,710.99	
341. Clearing Land and Rights-of-way	9,358.78	
342. Structures and Improvements	21,411.84	
343. Station Equipment	457,160.11	
344. Towers and Fixtures	77,169.90	
345. Poles and Fixtures	362,935.97	
346. Overhead Conductors and Devices	361,324.10	
348. Underground Conductors and Devices	203,195.22	
Distribution Plant		
350. Land and Land Rights	64,008.36	
351. Structures and Improvements	92,768.14	
352. Station Equipment	1,173,748.74	
354. Poles, Towers and Fixtures	1,058,599.59	
355. Overhead Conductors and Devices	1,227,592.23	
356. Underground Conduit	781,990.40	
357. Underground Conductors and Devices	741,086.24	
358. Line Transformers	886,481.33	
359.1 Services—Overhead	420,786.20	
359.2 Services—Underground	364,472.56	
360. Meters	576,078.75	

	Debit	Credit
361. Installations on Customers' Premises	8,744.62	
362. Leased Property on Customers' Premises	1,043.09	
363. Street Lighting and Signal Systems	165,645.58	
General Plant		
370.3 Land and Land Rights—Stores	11,611.28	
371.2 Structures and Improvements —Transportation	5,514.71	
371.3 Structures and Improvements —Stores	15,535.00	
372. Office Furniture and Equipment	13,595.50	
373. Transportation Equipment	41,661.13	
374. Stores Equipment	1,024.78	
375. Shop Equipment	220.60	
376. Laboratory Equipment	44,746.06	
377. Tools and Work Equipment	12,600.71	
378. Communication Equipment	16,473.44	
379. Miscellaneous Equipment	459.36	
Total	$11,300,033.96	
100.4 Electric Plant Held for Future Use	41,616.37	
107. Electric Plant Adjustments	3,744,030.74	
108. Other Utility Plant		
Common Utility Plant		
Intangible Plant		
301. Organization	5,798.46	
302. Franchises and Consents	432.43	
303. Miscellaneous Intangible Plant	109,583.55	
Steam Production Plant		
310. Land and Land Rights	181,768.51	
311. Structures and Improvements	868,387.08	
312. Boiler Plant Equipment	1,269,838.27	
314. Turbo-Generator Units	1,116,205.55	

		Debit	Credit
315.	Accessory Electric Equipment	263,929.23	
316.	Miscellaneous Power Plant Equipment	105,816.19	
	General Plant		
370.3	Land and Land Rights—Stores	71,339.11	
371.2	Structures and Improvements —Transportation	5,227.61	
371.3	Structures and Improvements —Stores	166,549.95	
371.7	Structures and Improvements —Miscellaneous	291.35	
372.	Office Furniture and Equipment	128,595.04	
373.	Transportation Equipment	73,921.93	
374.	Stores Equipment	7,835.14	
375.	Shop Equipment	5,871.87	
377.	Tools and Work Equipment	40,527.83	
379.	Miscellaneous Equipment	4,967.14	
	Total	$ 4,426,886.24	
	Steam Heating Plant in Service		
343.	Transmission Mains	154,893.09	
354.	Distribution Mains	774,776.85	
359.	Services	153,689.63	
360.	Meters	75,447.62	
361.	Installations on Customers' Premises	84,459.31	
	Total	$ 1,243,266.50	
	Steam Heating Plant Adjustments	20,048.38	
110.	Other Physical Property	253,506.57	
126.2	Accounts Receivable from Associated Interests	9.75	
100.6	Electric Plant in Process of Reclassification		$21,029,369.96
250.	Reserve for Depreciation of Electric Plant		28.55
		$21,029,398.51	$21,029,398.51

(2) Northwestern Electric Company make the following disposition of the amounts recorded in Account 107, Electric Plant Adjustments:

(a) For each year, commencing with the calendar year 1940, it shall credit Account 107, Electric Plant Adjustments and charge Account 414, Miscellaneous Debits to Surplus with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend appropriations for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished.

(b) Transfer by journal entry the sum of $243,953.47, on or before December 31, 1940, from Account 107, Electric Plant Adjustments, to Account 151, Capital Stock Expense.

(c) Transfer by journal entry the sum of $77.27, on or before December 31, 1940, from Account 107, Electric Plant Adjustments, to Account 271, Earned Surplus.

(3) Northwestern Electric Company file with the Commission, on or before January 31, 1941, certified copies of the journal entries required by paragraphs (1), (2b), and (2c), and also file certified copies of the journal entry required by paragraph (2a) on or before April 1, 1941, and for each year thereafter, as required.

By the Commission.

(Sgd) LEON M. FUQUAY
Secretary.

[Title of Board and Cause.]

APPLICATION FOR REHEARING

Northwestern Electric Company (hereinafter sometimes called the "Company"), being aggrieved by the order (hereinafter sometimes referred to, with the "Opinion and Findings" on which such order is based, as the "Order") in the above-entitled proceeding dated December 6, 1940, but issued by the Commission on December 11, 1940, respectfully applies, pursuant to the provisions of Section 313 (a) of the Federal Power Act (hereinafter sometimes referred to as the "Act"), for a rehearing in said proceeding on the following specific grounds:

I. The Commission erred (i) in holding that it has jurisdiction over the general corporate and other fundamental accounts and records of the Company and jurisdiction to compel a revision thereof and (ii) in making and entering the Order, which purports to exercise such jurisdiction and to require a restatement of the general corporate accounts of the Company in accordance with the "reclassification journal entry" in paragraph (1) of the Order set forth.

A. The Company is subjected by the statutes of Oregon and Washington to comprehensive state regulation with respect to its books of account and accounting practices. The Order thus disregards both the specific limitation of the Commission's accounting jurisdiction to the "purposes of administration of this Act" and

the further limitation of the jurisdiction of the Commission to certain electric facilities and such matters with respect thereto as are not subject to regulation by the states and violates the fundamental constitutional limitation on the Federal Government with respect to the regulation or control of local business, particularly in the manner directed.

B. In this respect, the Order (a) is based upon a mistake of law arising out of the Commission's misconstruction of the statute under which it purports to act, (b) assumes to exercise powers not granted to the Commission by the Act and (c) is contrary to the express provisions of the Act, particularly Sections 3(13), 19, 20, 201, 207, 208, 301(a) and 318 thereof, which limit both the accounting jurisdiction and the general jurisdiction of the Commission.

II. The Commission erred (i) in making its Finding[1] that the Company has not complied with

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1. The word "Finding" is here employed because the Commission's determinations numbered (1) to (8), inclusive, as set forth at pp. 32-34 of its Opinion, are so entitled. Said determinations and the preceding statements in the Commission's Opinion, which purport to set forth the bases or grounds for its determinations, consist largely of conclusions of law or of mixed findings of fact and conclusions of law and do not comprise such "findings as to the facts," as are referred to in Section 313(b) of the Act, but for the sake of brevity, the Company refers to said determinations (1) to (8), inclusive, as "Findings" and to the preceding expressions of opinion as "findings or conclusions."

the reclassification requirements of the Commission's Uniform System of Accounts, in that it (the Company) has included in Account 100.1, Electric Plant in Service, the amount of $31,389.87, representing the cost to the Company of interest during construction from 1914 through 1925 and (ii) in ordering the Company to enter on its books the reclassification journal entry set forth in paragraph (1) of the Order, which omits such costs.

A. The opinion of the Commission finds or concludes, as apparent bases for its said Findings, (a) that the Company seeks to add to recorded cost additional amounts which it had previously decided were not a part of the cost of its plant, (b) that the present recordation of such amounts would impeach the past accounting of the Company, (c) that the omission of such costs is not erroneous under the Commission's system of accounts and that said system of accounts does not sanction the present inclusion of such costs, and (d) that the computation of such costs is based upon the theoretical use of the Company's own funds and does not represent identifiable interest costs. The Company assigns error with respect to each of such findings or conclusions.

(1) Per contra, such costs were actually incurred by the Company and are recognized as true components of construction cost by the Commission's system of accounts. Nor is the inclusion of such interest costs prohib-

ited by any provision of the system of accounts. The amounts so included for interest during construction were identified and computed in accordance with proper accounting practices and pursuant to the provisions of the system of accounts and neither the method of identification nor the manner of computation was challenged by the Joint Report of the examiners of this Commission and the Oregon Public Utilities Commissioner or by any witness (Ex. 6: Definitions —10, Instructions—Electric Plant Account 2C, 3A, 3C and 5(17); Ex. 3, page 14).

(2) There is no evidence in the record that the Company made, or at any time attempted or purported to make, any determination that such interest costs were not a part of the cost of plant or were properly allocable or distributable to any account other than plant.

(3) The uses and purposes for which the Commission's system of accounts was authorized (subject to the jurisdictional limitations imposed by the Act and by the Constitution of the United States) and to which such system of accounts may properly be devoted in connection with the discharge of the administrative duties imposed upon the Commission by the Act (i. e., determinations respecting rates, security issuances, the acquisition or disposition of property, and such other determinations as the Commission is empowered to

make) require that the reclassification to be made pursuant to such system of accounts reflect the actual cost of construction of electric plant.

(4) The inclusion of similar interest costs is permitted by the system of accounts to other utilities subject thereto whenever such costs were recorded in the accounts of a company at the time they were incurred or whenever original cost has been required to be estimated because adequate accounting records were not available. Thus the exclusion of such interest costs from the accounts of the Company is a discrimination which is not rested upon any permissible classification, has no reasonable relation to the objectives of the Act and operates to deny and forbid a uniform application of the system of accounts.

(5) The amount of such interest costs has not been charged to any other account of the Company. The Commission on its own behalf seeks to revise and restate the accounts of the Company and if such restatement or revision is proper, the correction of the failure to include interest costs may not be considered to impeach the past accounting of the Company or impair the integrity of its past income and balance sheet statements.

(6) The Commission's contention that the capitalization of such interest costs would "impeach" past accounting and would "start us on the road to chaos in accounting" is

based upon a fundamental misconception of what the Company actually has done. In its reclassification study, the Company, on the one hand, *debited** these interest costs to Account 100.1 for the purpose of disclosing actual original cost as required by the Commission's system of accounts and, on the other hand, *credited* such interest costs to Account 107, Electric Plant Adjustments, Utility Plant, in the aggregate, was not affected at all, since the debit to Account 100.1 was offset by the credit to Account 107. *No income or other accounts have been or are proposed to be affected by this transaction.* The Company has not proposed and does not propose to transfer to surplus any credit balance in Account 107.

B. In the foregoing respects, the Order is contrary to the system of accounts and is arbitrary and without the sanction of law, in that it (a) is not supported by substantial evidence and is contrary to uncontradicted evidence submitted herein, (b) is contrary to the provisions of the Act in that the Commission's construction of its system of accounts prevents a uniform application thereof to the subjects to which it is made applicable and renders the system arbitrary, discriminatory and capricious, and (c) applies an arbitrary and unreasonable test of cost by

*Italics in this paper appear in the original copy.

making definitive and determinative past accounting acts or practices which have no reasonable relation to the facts sought to be ascertained.

III. The Commission erred (i) in making its Finding that the Company has not complied with the reclassification requirements of the Commission's Uniform System of Accounts, in that it has included in Account 100.1, Electric Plant in Service, an amount representing administrative and general expenses charged to expense in the years 1926 to 1936, inclusive, and (ii) in ordering the Company to enter a reclassification journal entry which omits all such costs.

A. The opinion of the Commission finds or concludes, as apparent bases for said Finding, (a) that the present inclusion of such administrative and general costs in the reclassification statements of the Company impeaches the past accounting of the Company, (b) that there is no difference between the elements of cost contained in the applicable old and new system of accounts, (c) that the present restatement of such administrative and general costs would result in an added charge to expense in the form of depreciation and would vitiate the principles of equity with respect to the Company's consumers and (d) that the system of accounts does not permit any revision of the past distribution of costs between operating expense and charges to capital. The Company assigns error with re-

spect to each of these findings or conclusions. The Commission also erred in adopting such conclusions without determining whether the total amount charged to expense over the entire accounting period of the Company reasonably reflected its costs of operation.

(1) The conclusion that such restatement would result in an added charge to expense in the form of depreciation and would vitiate the principles of equity with respect to the consumers of the Company is not supported by substantial evidence or by any findings of the Commission. Over-all depreciation charges could not conceivably be increased by what the Company proposes (see sub-paragraph (3) hereof, infra) because the debit to Account 100.1 made for the purpose of recording the administrative and general costs under consideration is completely offset by a credit to Account 107, Electric Plant Adjustments. And, in any event, the Company might be entitled to have any credit balance in Account 107 transferred directly to Account 250, Reserve for Depreciation. The use of such reclassified accounts (subject to the limitations referred to in II A(3) hereof) by the Commission in the determinations which it is permitted to make in respect to rate bases, security issuances and the disposition or acquisition of property and other matters requires the use of actual costs of construction

(c) Adjustment of the electric plant accounts of the Company to conform to the requirements of the Commission's System of Accounts does not impeach or affect the integrity of previous income or other financial statements of the accounting utility.

(d) The Company should include in the said reclassification of its accounts filed with the Commission pursuant to the Commission's said System of Accounts all items of cost and original cost provided for in said System of Accounts, as the terms "Cost" and "Original Cost" are therein defined, whatever may have been the historical accounting treatment of such items of cost.

(e) The said System of Accounts was promulgated and prescribed for purposes of the administration of the Federal Power Act and that nothing contained in said Act or in said System of Accounts requires any public utility subject thereto to keep and maintain its corporate or general books of account in compliance with such System of Accounts or to keep or maintain such System of Accounts with respect to its own properties and operations for any purpose other than the limited purposes of administration of the Federal Power Act.

(f) The disposition of the amount or amounts, if any, ultimately required to be re-

corded by the Company in Account 107, Electric Plant Adjustments, for the purpose of this Commission's Uniform System of Accounts for Public Utilities and Licensees, is not in issue in this proceeding and could not lawfully be determined presently by the Commission either on the basis of the record in this proceeding or otherwise.

IX. The Company hereby incorporates by reference the "Brief for Company" and "Reply Brief for Company", which were filed in this proceeding, as a part of and in support of this Application and refers to said briefs for a more particular statement with respect to certain of the issues herein presented.

X. The said opinion, findings and order of the Commission in the particulars hereinbefore set forth violate Articles V and X of the Amendments to the Constitution of the United States and deprive the Company and the holders of its securities of property without due process of law.

Wherefore, said Northwestern Electric Company respectfully requests that the Commission grant a rehearing in respect to the above-entitled proceeding; that the opinion, findings and order adopted, made and entered in said proceeding be abrogated; that the specific findings and conclusions requested in the Applicant's briefs in this proceeding be made and adopted; that the Commission's Order herein

be stayed until a reasonable time after the Commission shall have acted upon this application for rehearing and that the Applicant be granted such other and further relief as may seem just and proper in the premises.

Respectfully submitted,

NORTHWESTERN ELECTRIC COMPANY

JOHN A. LAING,
Vice-President.

LAING & GRAY,
By: JOHN A. LAING,
HENRY S. GRAY,
Public Service Building,
Portland, Oregon;

REID & PRIEST,
By: A. J. G. PRIEST,
SIDMAN I. BARBER,
Two Rector Street,
New York, New York,
Counsel.

State of Oregon,
County of Multnomah—ss.

I, John A. Laing, being first duly sworn, on oath, do state that I am the Vice-President of the Northwestern Electric Company, the Applicant herein; that I have read the foregoing application for rehearing and know the contents thereof; and that

said application and the statements therein made are true to the best of my knowledge and belief.

JOHN A. LAING.

Subscribed and sworn to before me this 7th day of January, 1941.

[Notarial Seal] JEAN McGILCHRIST,
Notary Public for Oregon.

My Commission Expires August 2, 1944.

AFFIDAVIT OF C. W. PLATT.

[Title of Board and Cause.]

I, C. W. Platt, being first duly sworn, on oath depose and say:

I am the duly elected and acting secretary and the duly elected and acting treasurer of the aforementioned Northwestern Electric Company, and have held said offices since March 18, 1925. As the holder of said offices, I have been and am in charge of the corporate and financial books and records of said Company, and of all matters in its behalf pertaining to its accounting and accounting practices, including all matters relating to the "Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937", in response to Electric Plant Instruction 2-D of the Uniform System of Accounts prescribed by the Federal Power Commission, and to said Commission's order with respect thereto dated May 1, 1937.

As such officer, I received on July 1, 1940, in the course of regular mail from Washington, D. C., a copy of the Commission's order dated June 18, 1940, but not filed until June 26, 1940, reference to which is made in the Application for Rehearing to which this affidavit is to be annexed. Said order provided and directed only that:

> "(1) A public hearing be held on July 15, 1940, at 10 a. m. in the Circuit Court of Appeals Court Room 704, U. S. Courthouse Building, Portland, Oregon, and that at the hearing the Northwestern Electric Company show cause why the Federal Power Commission should not find and determine by order that adjusting entries be made to bring the books of account in conformity with the joint 'Report on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937';"
>
> "(2) The Public Utilities Commissioner of Oregon and the Washington Department of Public Service may participate in the hearing as provided in Part 39, Section 39.4 of this Commission's Rules of Practice and Regulations prescribed pursuant to the provisions of the Federal Power Act."

As stated in the Company's Reply Brief herein (pp. 2-9), and as again set forth in the Company's Application for Rehearing (Point V-A, and subdivisions (1), (2), (3), and (4), pages 8-10), the

officers of the Company were not notified by the Commission's Show Cause Order of June 18, 1940, which initiated this proceeding, or in any event did not interpret or understand said Order as giving notice, that the ultimate disposition of any amount that might be transferred to Account 107, as the result of such proceeding, was then an issue or would be given any consideration therein. The officers of the Company understood at that time, as they did throughout the hearing in said proceeding, that if and when the Commission should determine that any amount should properly be required to be transferred to said Account 107, the Commission would then in due course, and on appropriate notice, initiate a further proceeding to determine what disposition if any should be made of the amount so required to be transferred. This understanding was based on the terms of the Commission's Show Cause Order initiating the proceeding and on the advice of the Company's counsel, and was confirmed by the testimony and comments of the Chief of the Commission's Bureau of Accounts in the course of the hearing, referred to at page 5 of the Company's Reply Brief.

Aside from these considerations, however, it would have been quite impossible for the Company, in the brief space of time intervening between the receipt of notice of the hearing and the hearing itself, to assemble in satisfactory form for presentation in evidence the necessary facts and data per-

tinent to the disposition, if any, to be made of such amount as the Commission might ultimately determine should be transferred to Account 107.

Among other things, and assuming that such transfer involved the $3,500,000 of stated value of the common stock, such evidence would have included a detailed showing as to the fair present value of the Company's property against which its securities including the common stock are outstanding, a showing which would have involved the presentation of an inventory and appraisal of all of the Company's property as of the current date, based on the cost of reproducing such property less proper allowance for accrued depreciation, together with an appraisal of all other elements properly entering into the fair present value of the property against which such securities were and are outstanding. In addition to such detailed evidence of value, the Company would have considered it proper and necessary to present other evidence bearing upon the disposition of the amount if any to be included in said Account 107, including evidence upon the other various matters enumerated on pages 6-7 of the Company's Reply Brief herein.

Such a task, if the officials of the Company had considered it to be in order at the time of the hearing, would have required at least ninety days of preparation in advance of the hearing, taking into full account the very substantial amount of work

previously performed by the Company's staff and its consulting engineer, E. C. Willard, in making such inventory and such appraisal as of an earlier date, and would have been manifestly impossible of performance within the three weeks' time available between July 1, 1940, the date of receipt of the Commission's notice of hearing, and the actual date of the hearing, namely, July 22, 1940.

During said period between July 1 and July 22, 1940, the members of the accounting and operating staffs of the Company were completely occupied with the preparation of the information and data actually presented at the hearing, dealing with the matters and issues which the Company and its officers and counsel in good faith believed were included within the scope of the Show Cause Order and notice, and in good faith believed were the only matters and issues so included; and would have had no time within said period to devote to the consideration of the matter of the ultimate disposition of any amount that might be required to be transferred to Account 107, had said matter been considered as included within the scope of said proceeding.

I am the same C. W. Platt who made affidavit herein on July 2, 1940, in support of the Company's Application for Continuance of the hearing then set for July 15, 1940; and I further depose and say that, at the time of making such Application for Continuance and such affidavit in support thereof,

I had no thought or intimation that the matter of the disposition of said Account 107 was to be an issue in said proceeding; and my affidavit in support of such application for a thirty days' continuance related to the minimum amount of time reasonably required for the preparation of evidence pertinent to the other matters and issues which then appeared, in the light of the Commission's notice and Show Cause Order, to be involved in said proceeding.

C. W. PLATT.

Subscribed and sworn to before me this 6th day of January, 1941.

[Notarial Seal] JEAN McGILCHRIST
Notary Public for Oregon

My commission expires August 2, 1944.

[Title of Board and Cause.]

January 21, 1941.

ORDER ON APPLICATION FOR REHEARING

It appearing to the Commision that:

(a) On December 6, 1940, the Commission adopted Opinion No. 56 and an order herein Directing Accounting Entries in Reclassification and Disposition of Amounts in Account 107, wherein the Commission ordered Northwestern Electric Company to enter on its books

not later than December 31, 1940, and as of December 31, 1936, the reclassification journal entry set out in paragraph (1) of said order and to make the dispositions, set out in paragraphs (2a), (2b), and (2c) of said order, of the amounts recorded in Account 107, Electric Plant Adjustments, and to file with the Commission certified copies of the journal entries required by paragraphs (1), (2a), (2b), and (2c) of the said order; and said Opinion and order were served upon Northwestern Electric Company by mailing copies thereof to its attorneys on December 11, 1940;

(b) On December 30, 1940, the Commission adopted an order providing in part that "pending an application for rehearing herein in accordance with Section 313 of the Federal Power Act and the decision of the Commission upon such application for rehearing, the Commission's order herein adopted December 6, 1940, be and the same hereby is stayed until further order of the Commission";

(c) On January 9, 1941, Northwestern Electric Company filed its application for rehearing with respect to said Opinion and order of December 6, 1940;

The Commission *orders* that:

(A) A rehearing be held on February 10, 1941, at 9:30 a. m. in the hearing room of the

Federal Power Commission, 1800 Pennsylvania Avenue, N. W., Washington, D. C., for the purpose only of permitting the presentation of a plan of disposition of the amount of $3,500,000 write-up which the Commission, in paragraph (2a) of its order of December 6, 1940, ordered Northwestern Electric Company to make disposition of, by crediting Account 107, Electric Plant Adjustments, and charging Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend appropriations for each calendar year, commencing with the calendar year 1940, until the amount of $3,500,000 shall have been entirely extinguished, provided, however, that this grant of rehearing shall not be construed as acknowledgment by the Commission that the character of evidence set out in the application for rehearing is considered relevant and material to the issue at rehearing;

(B) In all other respects the application for rehearing be and the same hereby is denied, and the order of the Commission as set out in paragraphs (1), (2b), and (2c) of its order of December 6, 1940, is reaffirmed and adhered to;

(C) The Commission's order of December 30, 1940, is modified to the following extent:

(1) So much of said order as stayed paragraphs (1), (2b), and (2c) of the Commis-

sion's order of December 6, 1940, and as stayed the filing of the journal entries required by virtue of the orders contained in said paragraphs (1), (2b), and (2c), is hereby vacated, and Northwestern Electric Company is hereby ordered to enter on its books not later than February 15, 1941, and as of December 31, 1936, the reclassification journal entry set out in said paragraph (1), and not later than February 15, 1941, to make the transfers by journal entries set out in said paragraphs (2b) and (2c) and to file with the Commission on or before March 15, 1941, certified copies of said journal entries required by said paragraphs (1), (2b), and (2c);

(2). In all other respects the Commission's order of December 30, 1940, shall remain in full force and effect until further order of the Commission;

(D) The Public Utilities Commissioner of Oregon and the Washington Department of Public Service may participate in the rehearing, as provided in Part 39, Section 39.4 of this Commission's Rules of Practice and Regulations, prescribed pursuant to the provisions of the Federal Power Act.

By the Commission.

LEON M. FUQUAY,
Secretary.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 9756

NORTHWESTERN ELECTRIC COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR REVIEW OF ORDER OF FEDERAL POWER COMMISSION

To the Honorable The United States Circuit Court of Appeals for the Ninth Circuit, and to the Judges thereof:

Northwestern Electric Company (hereinafter sometimes called the "Petitioner") being aggrieved by the Order of the Federal Power Commission dated December 6, 1940, but issued by said Commission on December 11, 1940, in the proceeding bearing said Commission's Docket Number IT-5642, hereby respectfully petitions this Honorable Court, pursuant to Section 313(b) of the Federal Power Act, for a review of said Order of said Commission, and respectfully shows:

I. Petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of Washington and is doing business as a public utility in the States of Washington and Oregon under and by virtue of compliance with the

laws of said states. The property of Petitioner comprises electric and non-electric facilities. All of its non-electric facilities and the major portion of its electric facilities are devoted solely to intrastate uses. More than 88% of such electric facilities (on the basis of their cost) are used for the generation of electric energy or in the local distribution thereof. Petitioner is subject to comprehensive regulation by the authorities of said states of Washington and Oregon as to accounting, rates, adequacy of service, contracts with affiliated interests and every other aspect of its business which concerns the general public.

II. The Federal Power Commission, hereinafter sometimes called "Commission", is the administrative body entrusted with the administration of the Federal Power Act, 16 U. S. C. A., §§ 791 et seq., hereinafter sometimes referred to as the "Act".

The Commission is authorized by the terms of the Act to investigate and ascertain the actual legitimate cost of the property of public utilities and the fair value of such property, to require that every public utility file a statement of the original cost of its property, to determine the fair value of projects already constructed for which license is sought, and to prescribe a uniform system of accounts to be kept by licensees and public utilities. The Commission is authorized by the terms of the Act to make determinations with respect to certain rates, security issuances, the acquisition or disposition of property and other matters over which the Commission

has jurisdiction. Such federal regulation is, however, subject to the proviso of Section 201(a) of the Act that such jurisdiction of the Commission shall "extend only to those matters which are not subject to regulation by the States", and also is subject to the provision of Section 201(b) of the Act that the "Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this Part and the Part next following, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter."

III. The Commission, purporting to act under authorization of the Act, by its order Number 42 adopted June 16, 1936, as amended by its order Number 43 adopted December 31, 1936, prescribed a so-called Uniform System of Accounts for public utilities and licensees. Said System of Accounts, as supplemented by the Commission's order of May 11, 1937, directed all public utilities to reclassify their electric plant accounts and to submit to the Commission certain statements showing pro forma a reclassification of their electric plant accounts in conformity with the provisions of said System of Accounts. The said System of Accounts differs substantially from the systems of accounts previously applicable to the Petitioner and other public utili-

ties. The Commission is undertaking and now threatens, by and through the medium of said System of Accounts and by ordering adjustments in the electric plant accounts of public utilities based thereon, unlawfully to employ a determination of so-called but incomplete cost of electric plant, so arrived at, in lieu of appropriate determination of property values, as the sole basis for many of the important determinations to be made by said Commission in the exercise of its jurisdiction.

Petitioner, reserving all rights to challenge the jurisdiction of the Commission over the accounts and accounting practices of Petitioner, submitted such pro forma reclassification statements to the Commission on May 27, 1939. On or about May 1, 1940, the Commission served upon Petitioner the Joint Report of the accounting examiners of the Commission's staff and the staff of the Public Utilities Commissioner of Oregon (hereinafter sometimes referred to as the "Joint Report"), which had been prepared after investigation of the Petitioner's reclassification studies and statements. The Joint Report recommended certain adjustments or changes in said reclassification statements, of which the following are relevant to the issues of the review herein sought:

(a) That costs incurred by Petitioner for interest during construction in the stated amount of $34,959.79 (such amount having been subsequently corrected by Petitioner to $31,389.87) should be excluded from such reclassi-

fication statements and from the Petitioner's electric plant account as reclassified, because Petitioner had failed to record such costs at the time when they were incurred.

(b) That the amount of $3,500,000, reclassified by Petitioner in Account 301, Organization, and reflecting cost incurred by the Petitioner through and by the issuance of its Common Stock, should be transferred to Account 107.[1]

(c) That "the amount of $3,500,000 be retained in Account 107, Electric Plant Adjustments, pending the submission to the Commission of a plan for its disposition".[2]

---

1. Said System of Accounts (page 37) provides: "Account 107 is designed to show the amount by which the book cost of electric plant at the effective date of this system of accounts differs from the cost of the plant to the utility when the difference is not properly includible in other accounts. It shall include all write-ups in the books as of the effective date of this system of accounts."

2. Schedule III to the Joint Report entitled "Northwestern Electric Company—Balance Sheet—January 1, 1937 (setting forth amounts as shown by the company's original cost study and reflecting proposed adjustments of the Commission Staffs)" shows the retention in Account 107 of said amount of $3,500,000 after giving effect to the dispositions proposed by the Commission staff, as follows:

"PER COMMISSION STAFFS"

	Proposed Adjustments	After Adjustments	Proposed Adjustments	After Adjustments
107. Electric Plant Adjustments	$4,585,546.51	$3,744,030.74	$(244,030.74)	$3,500,000.00

IV. The Commission by its order dated June 18, 1940, ordered that a hearing be held and that, at such hearing, the Petitioner show cause why the Commission "should not find and determine by order that adjusting entries be made to bring the books of account of Petitioner in conformity" with the Joint Report. A copy of said order is attached hereto as Exhibit A and made a part hereof.

The Public Utilities Commissioner of Oregon and the Department of Public Service of Washington were, by subsequent orders of the Commission, made parties to such proceeding pursuant to their respective petitions in intervention. On December 11, 1940, the Commission issued its opinion and order dated December 6, 1940, directing the Petitioner to enter on its books not later than December 31, 1940, and as of December 31, 1936, a reclassification journal entry which omitted all such interest during construction costs, transferred said amount of $3,500,000 from Account 301, Organization, to Account 107, Electric Plant Adjustments, and further directed that

> "(2) Northwestern Electric Company make the following disposition of the amounts recorded in Account 107, Electric Plant Adjustments:
>
> (a) For each year, commencing with the calendar year 1940, it shall credit Account 107, Electric Plant Adjustments and charge Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from In-

come Account) less its Preferred Stock Dividend appropriations for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished."

A copy of said order of December 6, 1940, is attached hereto as Exhibit B and made a part hereof.

V. Petitioner, being aggrieved by said order of December 6, 1940, on January 9, 1941, filed with the Commission, pursuant to the provisions of Section 313(a) of the Federal Power Act, an Application for Rehearing in respect of all matters considered and disposed of in said order dated December 6, 1940, which this Court is petitioned to review. A copy of said Application for Rehearing is hereto attached as Exhibit C and made a part hereof.

VI. Upon consideration of such Application for Rehearing, the Commission, by order dated January 21, 1941, ordered that:

"(A) A rehearing be held on February 10, 1941 . . . *for the purpose only of permitting the presentation of a plan of disposition of the amount of $3,500,000*" which the Commission in its order of December 6, 1940, ordered Petitioner to make disposition of, "provided, however, that this grant of rehearing shall not be construed as acknowledgment by the Commission that the character of evidence set out in the application for rehearing is considered relevant and material to the issue at rehearing;" and

"(B) In all other respects the application for rehearing be and the same hereby is denied."

A copy of said order is hereto attached as Exhibit D and made a part hereof.

VII. Petitioner is unable to determine from the provisions of said order of January 21, 1941, whether the Commission intended thereby to provide or did provide that the issues of such rehearing include all questions appropriately related to the retention in or disposition from said Account 107 of the amount of $3,500,000 and the manner and character of any disposition which may or should be ordered; whether the grant of such rehearing removed the restriction of such order upon the payment of any dividends upon the Common Stock of the Petitioner, and whether the above quoted proviso of said order excludes from the issues at rehearing all evidence as to the value of the property of the Petitioner.

VIII. On January 30, 1941, Petitioner filed with and served upon the Commission an application: (a) seeking a change in the date and place of such rehearing; (b) asserting the uncertainties above set forth, and that it was unable to determine the issues of the rehearing and should not be required to proceed with the preparation of its case until the Commission's order on application for rehearing was made more definite and certain in the particulars set forth; and (c) praying that the Commission's

order on application for rehearing be made more definite and certain in said particulars. The Commission in response to said application issued its order dated February 1, 1941, which order granted the requested change in date and place of rehearing. However, the Commission failed and refused to make the issues of such rehearing more definite or certain in any respect and, in consequence, Petitioner cannot determine whether the requirement of the Commission's Order of December 6, 1940, that Petitioner make disposition of the amount of $3,500,000 referred to in paragraph (2) (a) of said order and the restriction of said order upon the payment of any dividends upon the Common Stock of Petitioner have been stayed, modified or set aside.

IX. Petitioner avers that the said Order of the Commission dated December 6, 1940 (hereinafter sometimes referred to as the "Order") is unreasonable, arbitrary, and contrary to law or without authority in law, in the following particulars and for the following reasons:

1. The Commission erred in holding that it has jurisdiction over the general corporate and other fundamental accounts and records of the Petitioner and jurisdiction to compel a revision thereof.

2. The Commission's insistence upon original cost, as the Commission restrictively defines such cost, as the sole basis upon which the fundamental corporate records and books of account of public utilities and licensees are required to be kept, does vio-

lence to the concept of fair value recognized and confirmed not only by the Supreme Court of the United States and by the supreme courts of the states of Oregon and Washington, but also by the Act itself, particularly Sections 23(a) and 208(a) thereof.

3. The Commission erred in making and entering the Order, which purports to exercise jurisdiction over such accounts and records and to require a restatement of the general corporate accounts of the Petitioner in accordance with the "reclassification journal entry" in paragraph (1) of the Order set forth.

(a) The Petitioner is subjected by the statutes of Oregon and Washington to comprehensive state regulation with respect to its books of account and accounting practices. The Order thus disregards both the specific limitation of the Commission's accounting jurisdiction to the "purposes of administration of this Act" and the further limitation of the jurisdiction of the Commission to certain electric facilities and such matters with respect thereto as are not subject to regulation by the states, and violates the fundamental constitutional limitations on the Federal Government with respect to the regulation or control of local business, particularly in the manner directed.

(b) In this respect, the Order (a) is based upon a mistake of law arising out of the Commission's misconstruction of the statute under which it purports to act, (b) assumes to exer-

cise powers not granted to the Commission by the Act, and (c) is contrary to the express provisions of the Act, particularly Sections 3(13), 19, 20, 201, 207, 208, 301(a), and 318 thereof, which limit both the accounting jurisdiction and the general jurisdiction of the Commission.

4. The Commission erred in making its Finding[3] that the Petitioner has not complied with the reclassification requirements of the Commission's Uniform System of Accounts, in that it (the Petitioner) has included in Account 100.1, Electric Plant in Service, the amount of $31,389.87, representing the cost to Petitioner of interest during construction from 1914 through 1925.

5. The Commission erred in ordering the Petitioner to enter on its books the reclassification journal entry set forth in paragraph (1) of the Order, which omits such costs.

6. The Commission erred in adopting the following supplementary or supporting findings or conclusions:

---

3. The word "Finding" is here employed because the Commission's determinations numbered (1) to (8), inclusive, as set forth at pp. 32-34 of its Opinion are so entitled. Said determinations and the preceding statements in the Commission's Opinion, which purport to set forth the bases or grounds for its determinations, consist largely of conclusions of fact and conclusions of law and do not comprise such "findings as to the facts" as are referred to in Section 313(b) of the Act, but for the sake of brevity, the Petitioner refers to said determinations (1) to (8), inclusive, as "Findings" and to the preceding expressions as "findings or conclusions".

(a) that the Petitioner seeks to add to recorded cost additional amounts which it had previously decided were not a part of the cost of its plant,

(b) that the present recordation of such amounts would impeach the past accounting of the Petitioner,

(c) that the omission of such costs is not erroneous under the Commission's system of accounts and that said system of accounts does not sanction the present inclusion of such costs, and

(d) that the computation of such costs is based upon the theoretical use of the Petitioner's own funds and does not represent identifiable interest costs.

In the foregoing respects, the Order is contrary to the System of Accounts and is arbitrary and without the sanction of law, in that it (i) is not supported by substantial evidence and is contrary to uncontradicted evidence submitted in this case, (ii) is contrary to the provisions of the Act in that the Commission's construction of its System of Accounts prevents a uniform application thereof to the subjects to which it is made applicable and renders the system arbitrary, discriminatory, and capricious, and (iii) applies an arbitrary and unreasonable test of cost by making definitive and determinative past accounting acts or practices which, in this instance, have no reasonable relation to the facts sought to be ascertained.

7. The Commission erred in making its Finding:

(a) that the Petitioner has not complied with the reclassification requirements of the Commission's System of Accounts in that it has included in Account 100.1, Electric Plant in Service, the amount of $3,500,000 as Organization Expense,

(b) that such amount represents a write-up of plant account in the amount of the Petitioner's Common Stock presently outstanding and that such stock was issued without value having been received therefor, and

(c) that such amount should be included in Account 107, Electric Plant Adjustments.

8. The Commission erred in ordering the Petitioner to enter on its books the "reclassification journal entry" set forth in paragraph (F) of its Order which transfers said amount of $3,500,000 to said Account 107 and which attributes all of said amount to the electric plant of Petitioner.

9. The Commission erred in adopting the following findings or conclusions:

(a) that the determination made by the Petitioner of the cost to it of the electric plant for which Common Stock was issued in payment "is without probative value because it is not based upon the value of the consideration received" by the Petitioner at the time the Common Stock was issued,

(b) that "there is no reliable evidence in the record that any promoters' services of demon-

strable value or any other consideration was received" by the Petitioner for its Common Stock, and

(c) that the real cost of all the property of the Petitioner at the time of the issuance of its Common Stock was represented by debt securities, and at this time is not represented by any assets received by the Petitioner in exchange for it.

With respect to the foregoing assignments of error 7, 8, and 9, the Order is:

(i) arbitrary in that it is not supported by substantial evidence, disregards substantial evidence of the value of the consideration given, and attempts to impose upon the Petitioner an impossible burden of proof,

(ii) based upon a mistake of law arising out of the Commission's misconstruction of the statute under which it purports to act, in that it seeks to give a retroactive effect to the Act, particularly in imposing such burden of proof, and

(iii) disregards the right of the Petitioner to retain on its books of account asset values which are represented by present fair value and are not subject to being written off as required by the Commission.

10. The Commission erred in making its Finding that the amount of $3,500,000 representing the Common Stock now outstanding "should be disposed of by applying thereto all annual net income [in-

cluding income from non-electric operations] after allowance for Preferred Stock dividend requirements, until the disposition of the entire amount has been accomplished".

11. The Commission erred in ordering that: "For each year, commencing with the calendar year 1940, it [the Petitioner] shall credit Account 107, Electric Plant Adjustments and charge Account 414, Miscellaneous Debits to Surplus, with a sum equal to its Net Income (Account 400, Credit Balance Transferred from Income Account) less its Preferred Stock Dividend appropriations for each such calendar year until the amount of $3,500,000 shall have been entirely extinguished."

12. The Commission erred in holding that the matter of disposition of said $3,500,000 item was within the issues of the proceeding for which notice was given and a hearing had, and in adopting as its opinion the following findings or conclusions:

(a) that the matter of the disposition of said amount was in issue in this proceeding,

(b) that "evidence clearly shows" that the Petitioner "fully understood prior to the hearing that the question of disposition was an issue",

(c) that "every opportunity" was given the Petitioner "to submit evidence, to cross-examine the Commission's witnesses and to present argument on the subject",

(d) that, furthermore, in the Petitioner's "Motion to Dismiss", and in its supporting brief, it "recognized that the disposition of

amounts in Account 107, Electric Plant Adjustments, was an issue in this case",

(e) that "The Provisions of Account 107 require the disposition of the amounts recorded in that account", and

(f) that the "Commission would be justified, as a matter of proper accounting, in ordering under the provisions of Section 301(a) of the Federal Power Act, the immediate charging off of the amount in question".

X. The Commission erred in ordering any disposition of said $3,500,000 without regard to and consideration of (a) the value of the property and assets of the Petitioner which presently support its existing security structure, (b) its present balance sheet generally, or (c) its non-electric properties, operations and values, over which the Commission has no jurisdiction.

XI. The disposition of said amount of $3,500,000 so required by the Commission:

(1) was ordered without notice and hearing;

(2) represents the purported exercise of powers which are not granted to the Commission by the Act;

(3) invades powers reserved to the States by the provisions of the Act and by Article X of the Amendments to the Constitution of the United States;

(4) is not supported by substantial or any evidence and is therefore arbitrary and capricious;

(5) requires the writing-off on the Petitioner's books of account of values inherent in its property and reflected in its present accounts and thereby violates Article V of the amendments to the Constitution of the United States in that it deprives Petitioner of its property without due process of law and takes its property for public use without just compensation; and

(6) denies both to the Petitioner and to the holder of its Common Stock the "rudimentary requirements of fair play".

XII. The Commission erred in failing to make and enter the following findings of fact and conclusions of law specifically requested at pages 51 to 54 of the "Brief for Company", and at page 33 of the "Reply Brief for Company", such briefs having been submitted to the Commission and having, by reference, been made a part of Petitioner's Application for Rehearing referred to in Section V hereof:

A. Findings of fact:

(1) That the company is subject to comprehensive regulation by the States of Washington and Oregon as to rates, adequacy of service, issuance of securities, accounting, contracts with affiliated interests and all other aspects of its business which concern the general public of such states;

(2) That the tangible electric plant of the Company (other than general plant, which in-

cludes structures, equipment and other items which are employed in the operations of the Company and are not assignable as between generation, distribution and transmission facilities except on the basis of an apportionment) comprises facilities used for the generation of electric energy, facilities used in local distribution and facilities used for the transmission of electric energy. More than 88% of such facilities (on the basis of their cost) are used for the generation of electric energy or in the local distribution thereof (Ex. No. 1, Statement F; Ex. No. 3, pp. 10-13);

(3) That $31,389.87 represents interest during construction of the rate of 6% per annum not previously capitalized on actual construction costs of the Company incurred during the period from July 1, 1914 to December 31, 1925;

(4) That the Company properly included in the reclassification of its accounts filed pursuant to the Commission's Uniform System of Accounts for Public Utilities and Licensees the restatement of $31,389.87 representing interest during construction for the period from July 1, 1914 to December 31, 1925;

(5) That the cash value of the Common Stock of the Company at the time of its issuance was not less than the sum of $3,500,000;

(6) That the Company, in its said reclassification of its accounts, properly included in Account 301, Organization, the sum of $3,500,000 carried on its present books of account

as representing the par value of Common Stock issued to the organizers of the Company for their services in organizing the enterprise and putting it in readiness to do business.

B. Conclusions of law:

(a) The reclassification of electric plant pursuant to Electric Plant Instruction 2-D of the Commission's said System of Accounts is not an ascertainment of the actual legitimate cost of property, in accordance with the provisions of Section 208(a) of the Federal Power Act.

(b) The reclassification of electric plant, pursuant to said Electric Plant Instruction 2-D of said System of Accounts requires the redetermination of the over-all cost of the electric plant of the accounting utility and the adjustment, for the purposes of said System of Accounts, by exclusion or addition, of amounts not recorded in accordance with the provisions of said System of Accounts with respect to retirements, capital stock expense, capitalization of overheads and other items.

(c) Adjustment of the electric plant accounts of the Company to conform to the requirements of the Commission's System of Accounts does not impeach or affect the integrity of previous income or other financial statements of the accounting utility.

(d) The Company should include in the said reclassification of its accounts filed with the Commission pursuant to the Commission's

said System of Accounts all items of cost and original cost provided for in said System of Accounts, as the terms "Cost" and "Original Cost" are therein defined, whatever may have been the historical accounting treatment of such items of cost.

(e) The said System of Accounts was promulgated and prescribed for purposes of the administration of the Federal Power Act and that nothing contained in said Act or in said System of Accounts requires any public utility subject thereto to keep and maintain its corporate or general books of account in compliance with such System of Accounts or to keep or maintain such System of Accounts with respect to its own properties and operations for any purpose other than the limited purposes of administration of the Federal Power Act.

(f) The disposition of the amount or amounts, if any, ultimately required to be recorded by the Company in Account 107, Electric Plant Adjustments, for the purpose of this Commission's Uniform System of Accounts for Public Utilities and Licensees, is not in issue in this proceeding and could not lawfully be determined presently by the Commission either on the basis of the record in this proceeding or otherwise.

XIII. The said opinion, findings and order of the Commission violate, in the particulars hereinbefore set forth, Articles V and X of the Amendments to the Constitution of the United States and

deprive the Petitioner and the holders of its securities of property without due process of law.

XIV. All of the foregoing objections to said Order of the Commission, the setting aside of which is sought herein, were set forth and urged by the Petitioner before the Commission in the Application for Rehearing described in Section V of this petition.

XV. A copy of this petition will forthwith be served upon a member of the Commission.

XVI. The Commission's order of December 6, 1940, was stayed by an order entered by the Commission on December 30, 1940, "until further order of the Commission", with the proviso that, during the period of such stay, Petitioner should not declare or pay any dividends upon its Common Stock. By paragraph (C) (1) of its order of January 21, 1941, the Commission modified so much of its order of December 30, 1940, as stayed paragraphs (1), (2b) and (2c) of the Commission's order of December 6, 1940, and as stayed the filing of the journal entries required by virtue of the orders contained in said paragraphs (1), (2b), and (2c), and ordered the Petitioner to enter on its books, not later than February 15, 1941, and as of December 31, 1936, the reclassification journal entry set out in said paragraph (1), and not later than February 15, 1941, to make the transfers by journal entries set out in said paragraphs (2b) and (2c), and to file with the Commission on or before March 15, 1941, certified copies of said journal entries required by

said paragraphs (1), (2b), and (2c). By its order dated February 12, 1941, the Commission modified its order of January 21, 1941, by staying until March 15, 1941, and April 15, 1941, its requirements with respect to the making of such journal entries and transfers and the filing of certified copies thereof with the Commission.

XVII. Petitioner respectfully submits that it should not be required, during the pendency of the appeal effected by this petition for review, to enter such reclassification journal entry on its books or to make said transfers by journal entries or to file certified copies thereof with the Commission or otherwise to disturb its status quo. In this connection, Petitioner submits that if it complies with the direction of the Commission's order in this respect, the questions raised in this petition for review may become moot, thus denying Petitioner the right of judicial review provided for in Section 313 of the Act. Furthermore, such journal entries or transfers may not be considered to be definitive for any purpose, nor may any determination or order of the Commission be based thereon prior to this Court's determination of the issues herein, without denying to Petitioner the right of judicial review provided for in said Section 313 of the Act. On the other hand, if Petitioner fails and refuses to comply with the provisions of the Commission's order of December 6, 1940, as modified by its orders of December 30, 1940, January 21, and February 12, 1941, both the Petitioner and its officers may become subject to the fines, penalties and forfeitures prescribed by Sections 315 and 316 of said Federal Power Act.

XVIII. Neither the public interest nor the interests of investors or consumers could conceivably be adversely affected by a stay of the Commission's requirements in this respect, because, if the Commission's order of December 6, 1940, is sustained by this Court, Petitioner can and will be required to make, *nunc pro tunc*, said accounting entries and said transfers by journal entries and to file certified copies of said journal entries, as the Commission has required. If such accounting entries and transfers by journal entries could be made on March 15, 1941, as of December 31, 1936, they obviously may be made with equal propriety, if required to be made at all, after the determination of the issues raised in this petition for review.

Wherefore, Petitioner prays that said order of the Federal Power Commission dated December 6, 1940, and issued on December 11, 1940, be reviewed by this Honorable Court; that this Court grant forthwith a stay of the Commission's said order pending the determination of the issues raised in this petition for review; and that, upon such determination, this Court enter its judgment or decree wholly setting aside or annulling said order of the Commission and granting to Petitioner such other and further relief as may seem just and proper in the premises.

Respectfully submitted,

NORTHWESTERN ELECTRIC COMPANY,

By L. T. MERWIN,

President.

JOHN A. LAING,
HENRY S. GRAY,
Public Service Building,
Portland, Oregon.
A. J. G. PRIEST,
SIDMAN L. BARBER,
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New York, New York,
Attorneys for Petitioner.

LAING & GRAY,
Portland, Oregon.
REID & PRIEST,
New York, New York,
Of Counsel.

State of Oregon,
County of Multnomah—ss.

I, L. T. Merwin, being first duly sworn, depose and say that I am the President of Northwestern Electric Company, the Petitioner herein; that I have read the foregoing Petition and know the contents thereof, and that the same is true to the best of my knowledge and belief.

L. T. MERWIN.

Subscribed and sworn to before me this 20th day of February, 1941.

[Notarial Seal] JEAN McGILCHRIST,
Notary Public for Oregon.

My Commission expires August 2, 1944.

[Endorsed]: Filed Feb. 21, 1941. Paul P. O'Brien, Clerk.

[Title of Board and Cause.]

TESTIMONY

[Printers Note: Exhibit No. 1 is set out in Volume III]

EXHIBIT NO. 2

Northwestern Electric Company
Public Service Building
Portland, Oregon
May 27, 1939

Federal Power Commission
Washington, D. C.

Gentlemen:

Pursuant to Section 21 of your Uniform System of Accounts, and your order of May 11, 1937, there is submitted herewith a report comprising Statements "A" to "I" inclusive, as defined and set forth therein.

These statements are being submitted by the Company for the sole purpose of reporting pursuant to the provisions of your Uniform System of Accounts and your order of May 11, 1937, which requires the Company to classify its electric plant as of January 1, 1937, in accordance with prescribed accounts.

The information contained in these statements is based upon the books and records of the Company and other available information and upon estimates required by the uniform System of Accounts. Although the statements have been prepared as care-

fully as circumstances would permit in the limited time allowed by the Commission and are believed to be accurate, further study may disclose necessity for amending such statements either in whole or in part and the Company hereby reserves the right to amend such statements in whatever respect may be necessary in order more completely or more accurately to state the information set forth or which should be set forth therein.

The Company's accounting procedures are subject to regulation by the Public Utilities Commissioner of Oregon and by the Department of Public Service of the State of Washington and it may be that either or both of said authorities now claims or may hereafter claim jurisdiction over some or all of the matters to which the statements comprising this report relate. The Company reserves the right to question the jurisdiction of the Federal Power Commission over the matters to which this report relates as well as the validity and scope of the several provisions of the Federal Power Act and the validity and scope of any rule or regulation heretofore or hereafter made under said Act.

Yours very truly,
C. W. PLATT
Secretary and Treasurer

[Printer's Note: Exhibit No. 3 is set out in Volume III]

EXHIBIT NO. 4

Original Cost

Northwestern Electric Company,
Public Service Building,
Portland, Oregon.

Attention: Mr. C. W. Platt, Secretary-Treasurer.

Gentlemen:

There are enclosed three copies of a report of the Division of Original Cost of this Commission on the original cost study of your company submitted under date of May 27, 1939, pursuant to the provisions of Electric Plant Instruction 2-D of the Uniform System of Accounts prescribed by the Commission for Public Utilities and Licensees and the Commission's Order of May 11, 1937, in respect thereto.

It will be noted Pages 14 to 26, inclusive, and Page 29 of the report indicate that additional adjustments in the books and records of your company are necessary, and you are requested to make the adjustments indicated and to submit a copy of the adjusting journal entries to the undersigned not later than thirty (30) days from date hereof. You are also requested to submit a plan for disposing of the amount of $3,500,000 set forth on Page 29 of the report under Account 107, Electric Plant Adjustments, and described as the par value of 100,000 shares of the common capital stock of your company.

This letter and the report herein referred to shall not be construed as a finding of the original cost of the electric properties of your company by the Federal Power Commission. Likewise, nothing contained herein, or in the attached report, shall prejudice the authority of this Commission or any other regulatory body with respect to rates, estimates, or determinations of cost, evaluations, services, accounts, or any other matter whatsoever which may come before this Commission or such other regulatory body.

Very truly yours,

CHAS. W. SMITH, Chief
Bureau of Accounts, Finance and Rates.

Enclosure

cc Public Utilities Commissioner of Oregon
Washington Department of Public Service J. J. O'Neil

MVS:ac
4-29-40

EXHIBIT NO. 5

Northwestern Electric Company
Public Service Building
Portland, Oregon
May 31, 1940

Original Cost
Docket No. IT—5642
Federal Power Commission
Washington, D. C.

Gentlemen: Attention: Mr. Chas. W. Smith, Chief of Bureau of Accounts, Finance and Rates

Receipt is acknowledged of your letter dated May 1, 1940, and of the joint report of examiners of the Federal Power Commission and of the Public Utilities Commissioner of Oregon on the Reclassification and Original Cost Studies of Electric Plant as at January 1, 1937.

We have examined the report and noted with particular care the Adjustments Proposed by Commission Staffs, pages 14 to 16, inclusive, and page 29, to which reference is made in your letter.

There are attached hereto, in accordance with your request, copies of adjustments of the following items:

1. Transfers to Account 100.4, Electric Plant Held for Future Use (page 18 of examiners' report)
2. Transfers within Account 100.1, Electric Plant in Service (page 19 of examiners' report)

These adjustments are made in slightly different amounts than recommended by the examiners. Their computations did not include applicable amounts of certain overheads which are the subject of other captions in the report and of further discussion in this letter. We feel that the two entirely different questions, on the one hand, as to classification of costs of particular items of plant, and on the other, as to the determination of the amount of such costs, can best be clarified by separate treatment. That is, we feel that the proposed entry transferring costs should transfer amounts as reported in the original cost studies of this company and that the proposed adjustment of such amounts should be left for disposition under the appropriate caption.

With respect to the ultimate disposition of amounts in Account 107, Electric Plant Adjustments, we have studied the matter and as to the recommendation on page 29 of the examiners' report to transfer from Account 107 to Account 151, Capital Stock Expense, the amount of $243,953.47, representing expenses in connection with the sale of preferred stock, we recognize that such treatment of the item appears quite clearly to be required ultimately by the Uniform System of Accounts. Our understanding of the legal aspects of this matter is that the transfer of such expenses from plant account to another balance sheet account will not prejudice the right of the company to earn a return on such amount, to the extent that it represents fair value of the property used and useful in public service.

We also concur in part with the recommendation on page 29 of the examiners' report to write off from Account 107 against Account 271, Earned Surplus, the amount of $77.27, representing miscellaneous charges which were found by this company in its original cost study to have been charged improperly to the cost of transmission lands. This item is purely a correction of accounting distribution and is not fundamentally a question arising out of the original cost and plant reclassification studies. As a matter of fact and principle, however, it would seem that an adjustment of this kind and size should be considered as a "delayed item" to the operating expense account to which it would have been charged originally, had not an error in accounting distribution been made. General Instruction 6 of the Uniform System of Accounts would appear to be applicable and it would be helpful to have your opinion before the adjustment is made.

Your letter and the examiners' report raise certain questions with respect to the other adjustments proposed by the Commission staffs which we feel should receive further consideration. These fall into three categories, as follows:

1. Interest, taxes, and general administrative expenses applicable to cost or property (pages 14 to 16, inclusive, of examiners' report);

2. Organization expense in amount of $3,500,000 in consideration for common stock (pages 17 and 18 of examiners' report);

3. Use of common utility plant accounts (pages 19 to 22, inclusive, of examiners' report).

1. Interest, Taxes, and General Administrative Expenses Applicable to Cost of Property

This includes the first four items in the examiners' report under the subject, "Adjustments Proposed by Commission Staffs."

The text of the balance sheet account 100.1 Electric Plant in Service, states that the detailed plant accounts 301 to 390 shall record the original cost of electric plant.

Electric plant instruction 3-C, is quite definite and clear. It provides as follows:

> "C. Where the term 'cost' is used in the detailed electric plant accounts it * * * shall include not only the materials, supplies, labor, services, and other items consumed or employed in the construction and installation of electric plant, but also the cost of preliminary studies, plans, surveys, engineering, supervision, and general expenses, which contribute directly and immediately to electric plant without duplication of such costs."

We have endeavored to follow this instruction. We have assumed that the new System of Accounts is based on a uniform and consistent conception with respect to classification of both existing and future plant. It would not be uniform if costs of plant as of the effective date of the new system were to be stated on one or more old bases and future

costs on the new basis provided in the uniform system. It would not be consistent if items charged to plant accounts under the old systems in accordance with the provisions of such systems were eliminated because they are inadmissible under the provisions of the new system of accounts, while items which are required under the new system of accounts were not now so classified, so that the Original Cost of all of the Company's plant would be accurately revealed.

We are reluctant to believe that the Commission would take an inconsistent position, particularly when the language of Electric Plant Instruction 2-B, quoted by the examiners, does not use the same direct prohibitory langugage which is used in other of the instructions and notes enjoining the accounting utility from various acts. The reason for such distinction in language is not clear unless it was intended to allow consistency in reclassifying the present plant account.

In the last paragraph under the caption, "Reversal of Restatement of Interest on Average Cash Balances" (middle of page 15), and likewise in the last paragraph under the caption "Reversal of Restatement of Interest and Taxes on Construction Material Inventories" (middle of page 16), the opinion of the examiners is expressed that cash funds and material and supplies inventories, available for purposes of operation or construction, constitute an element of working capital, a return on which is included in the rates and charges of the

company to consumers. This method of computing interest during construction was adopted by the Company in an effort to expedite the conclusion of the study and the filing of the data required under the Commission's Order of May 11, 1937. It is still the Company's belief that the answer secured is sufficiently accurate for all practical purposes, but since the Commission's Examiners have taken exception to this approximate method, the Company will commence studies immediately which will disclose the actual amount of interest during construction on a basis of funds actually employed in the construction of its plant and property.

2. Organization Expense in Amount of $3,500,000 in Consideration for Common Stock

The par value of the Common Stock at the time that it was issued represented, in the opinion of the then Board of Directors, the value of the services and other consideration received. In 1925, a value of $5,000,000 was established by sale at an arms-length transaction, and in 1936, the par value of the Common Stock was reduced from $10,000,000, at which it had been issued originally, to $3,500,000.

On page 18 of their report, the examiners quote Electric Plant Instruction 3-D. The last sentence quoted reads, "The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration, if other than cash" (underscoring supplied). The examiners state that the Company has not determined the value of such consideration on a cash basis, and has not furnished the Commission the particulars of

its determination of such cash value. They do not say, however, that the utility is not prepared to furnish such particulars, and the statement that it has not determined the value is contradicted to some extent by their own quotation from the Company's original cost study. Of course, an entry in books of account of an item purporting to represent value in itself constitutes a determination of value.

We do not mean to imply that the statements quoted comprise all of the facts which could be submitted. For example, no mention has yet been made of the fact that after the sale of the Common Stock, referred to in the second paragraph preceding, for purposes of determining the amount of taxable income of the vendor, the Bureau of Internal Revenue allowed a very substantial value as at March 1, 1913.

Naturally a question arises as to the amount and nature of the evidence which reasonably may be considered sufficient to support a determination of value as of a date twenty-eight years in the past, particularly when the management of the Company long since has passed into the hands of entirely different interests. If, for example, the question had been raised during the first fourteen years of the life of the Company, those who had first-hand knowledge of the transactions would have been available to supply the required data. Of course, the System of Accounts does not provide the manner of determining value nor does it attempt to pass on what is sufficient evidence of value; it merely im-

plies that such determination should be made by the utility and provides that the utility shall be prepared to furnish the Commission the particulars of its determination.

3. Use of Common Utility Plant Accounts

On page 20 of their report, the examiners state that in accordance with Electric Plant Instruction 15 of the Uniform System of Accounts, they have transferred certain facilities used jointly for steam-production and for steam-electric generation from the accounts for electric plant in service to the accounts for common utilitiy plant.

There is more than one way provided for accounting for jointly used plant, and the provisions of the uniform system of accounts actually appear to discourage the use of common plant accounts. Their use is permitted only when it is impractiable to segregate such plant by utility services currently in the accounts, presumably only when the utility desires to use such accounts, and then only with the express approval of the Commission. Therefore, we are somewhat doubtful of the necessity for this proposed transfer.

The foregoing, we believe, covers those points in the examiners' report referred to in your letter of May 1, 1940. With respect to the letter itself, we are extremely apprehensive of the meaning of the third paragraph.

We find ourselves in the position of being requested to determine and reclassify the cost of items on our books and to submit the proposed reclassification entries to the Commissions, both of which we

have done. We are asked to make further adjustments. These entries and adjustments are of serious import, of unprecedented character, and, in some cases, contrary to the already expressed judgment of the management of the company.

Since some of these proposed entries do not reflect the judgment of the management of the Company, the question arises as to the authority for making them, if the regulatory authorities also disclaim a finding of cost. Moreover, when the reclassification entry is made in the books, we do not know whether the entries will be sustained, whether the results will be acceptable to regulatory authorities, or how many further adjustments may be requested.

We feel, therefore, that the meaning of the paragraph referred to should be clarified and its ultimate significance explained. You undoubtedly will agree with us as to the desirability of certainty and stability rather than suspense and instability. Perhaps we have misunderstood this paragraph, in which case the misunderstanding can be cleared by explanation of its meaning and the reason for its inclusion in your letter.

We have been reluctant to raise so many issues in this letter, but we feel that you will appreciate the need for a frank exchange of our views.

Yours very truly,

C. W. PLATT

Secretary and Treasurer

[Printer's Note: Exhibit No. 6 is set out in Volume III]

Mr. Slaff: Call Mr. William H. Bell please, Mr. Examiner.

WILLIAM H. BELL,

called as a witness on behalf of the Respondent, being first [23*] duly sworn, testified as follows:

Direct Examination

By Mr. Priest:

Q. You have been sworn, Mr. Bell?

A. I have.

Q. Please state your full name.

A. William H. Bell.

Q. Where do you reside?

A. Montclair, New Jersey.

Q. What is your profession, Mr. Bell?

A. I am a certified public accountant.

Q. What, if any, position do you hold with the firm of Haskins & Sells?

A. I am one of the senior partners of the firm of Haskins & Sells.

Q. Mr. Bell, how long has the firm of Haskins & Sells been practicing public accounting?

A. Since 1895.

Q. Who are some of the more important clients of your firm?

A. General Motors Corporation, United States Rubber Company, International Harvester Company, the DuPont interests, newspapers, a number

*Page number appearing at top of page of original Reporter's Transcript

(Testimony of William H. Bell.)

of the railroads, a number of banks, and a number of public utilities, including the Electric Bond and Share Company group. [24].

Q. Mr. Bell, please state what your educational training and professional experience have been.

A. I am a bachelor of commercial science of New York University, a master of commercial science of St. Louis University, and I have been connected with Haskins & Sells for thirty-one years and have been a partner for twenty-two years. I am a certified public accountant of about thirteen states, including New York, New Jersey, Pennsylvania, Ohio, Missouri, Colorado and Maryland. My experience has been very general covering all branches of professional accounting practice and all kinds of business activities. During the last few years, I have probably devoted more attention to public utilities than any other one class of business.

Q. Mr. Bell, would it be fair to say that you have specialized in public utility accounting in recent years? A. Yes, it would.

Q. Does the firm of Haskins & Sells audit the books of Northwestern Electric Company?

A. Yes, we have audited the books of Northwestern Electric Company for a number of years.

Q. Are you familiar with the Uniform System of Accounts prescribed by the Federal Power Commission effective as of January 1, 1937, for public utilities and licensees, the uniform system of ac-

(Testimony of William H. Bell.)

counts admitted in this proceeding as Exhibit Number 6? [25] A. I am.

Q. What, in your opinion, is the purpose of a uniform system of accounts?

A. No doubt the purpose of a uniform system of accounts for any particular industry is to effect standardization in order that a particular item in the financial statements of one company will be understood to be stated on the same basis as that of the same item of all other companies. It seems to me quite obvious that this is generally desirable. The practical significance of the standardization as to any particular item depends of course upon the use to which the information is put. It is desirable to have the accounts stated upon a uniform basis so that proper comparisons can be made of the affairs of one company with those of another. Of course, there are limitations upon the reliability of facts as expressed by accounts, that is to say, the accounts do not tell the whole story, but so far as the accounts go, they ought to be uniform in their incidence and application.

Q. Mr. Bell, would you say that one of the prime objectives of the uniform system of accounts here in evidence as Exhibit No. 6 is the statement or restatement of the cost of the properties of the accounting company?

A. I should say that it is, in view of the fact that the statement or restatement of the plant accounts on the basis of original cost as defined in the

(Testimony of William H. Bell.)

uniform system is the start- [26] ing point for the accounting for the most important features of accounting, which are the plant accounts and the operating expenses.

Q. Mr. Bell, what, in essence, are the accounting companies required to do by reason of the provisions of the Federal Power Commission's new system of accounts, having to do with the restatement of property accounts?

A. The companies are now called upon to state their property accounts on a new basis, in accordance with a new concept of cost, namely, the cost of the property when first devoted to the public service. This seems to me definitely to call for a restatement or reclassification of the plant accounts on the new basis regardless of how the accounts may have been kept in the past. In the electric industry as a whole, a substantial part of this reclassification work must be based upon estimates. That would necessarily require a restatement of plant accounts.

Q. What is the definition of cost set forth in the Federal Power Commission's new system of accounts?

A. In definition 10 of the Uniform System of Accounts, it is stated that "cost" means the amount of money actually paid for property or services or the cash value at the time of the transaction of any consideration other than money. The definition goes on to refer to Electric Plant Instruction 3. That instruction specifies that, as to plant acquired as an

(Testimony of William H. Bell.)

[27] operating unit or system, "cost" means the original cost incurred by the person who first devoted the property to utility service, and says that cost "shall include not only the materials, supplies, labor, services and other items consumed or employed in the construction or installation of electric plant, but also the cost of preliminary studies, plans, supervision, surveys, engineering, and general expenses, which contribute directly and immediately to electric plant without duplication of such costs." Instruction 5 includes among the components of construction cost all such items as engineering and supervision, general administration, insurance, taxes, and interest during construction.

Q. Mr. Bell, I hand you herewith the Federal Power Commission's Uniform System of Accounts, and that is already in evidence as Exhibit 6, and I direct your attention to paragraph 2 B, the last sentence of said paragraph 2 B. What have you to say as to the last sentence in said paragraph 2 B beginning with the words "It is likewise not intended"? Mr. Bell, what have you to say as to the last sentence of paragraph 2 B?

A. The sentence reads: "It is likewise not intended that adjustments shall be made to record in Electric Plant Accounts amounts previously charged to operating expenses in accordance with the Uniform System of Accounts in effect at the time or in accordance with the discretion of management as

(Testimony of William H. Bell.)

exercised [28] under such Uniform System of Accounts."

In my opinion this instruction may very well defeat the manifest purpose of the requirement for statement of the plant accounts as of January 1, 1937, on an original cost basis. Whether or not a certain expenditure represented cost of plant depends entirely upon its nature and purpose, and not at all upon its accounting treatment at the time. Previously, the companies, whether or not they were subject to regulatory authority, exercised considerable discretion and in some cases, no doubt, failed to exercise due care as to the accounting treatment of expenditures which might have been capitalized; in fact, it may safely be said that until comparatively recently there was no well defined, authoritative statement as to what items should be capitalized, and there can be no doubt that many capitalizable expenditures were charged to expense accounts through ignorance or through sheer indolence. Accounting practices have always varied — at least within certain limits — according to the general inclinations and even idiosyncrasies of individuals. Now all the companies are required to reclassify their properties in order to show their original cost, and there should be no discrimination between them. "Original" would seem to mean not only the cost when the property was first devoted to the public service, but also the definite, factual cost, actually incurred, not affected by write-ups or write-downs

(Testimony of William H. Bell.)

made at the time or later, advert- [29] ently or inadvertently. In those cases where items of property are now carried at less than original cost, the companies should, in all fairness, be allowed to adjust the accounts so that they will in fact reflect such original cost.

The Federal Power Commission has now set up rules for the determination of cost and original cost. There should not be one rule applying to property constructed prior to 1937 and another for that constructed since. If original cost is to have any significance whatever, for any purpose, it must mean the whole cost, and no more, of the units of property still in service, the component items being the same for all units, as nearly as can be determined.

Q. Then in your opinion, Mr. Bell, the actual cost of a particular item of property does not depend at all upon the way in which that cost was charged upon the books of the accounting company historically?

A. In my opinion, it does not. For example, a transmission line pole which cost $50.00 in place at the time of installation, has a cost of $50.00 quite regardless of whether all or any part of that $50.00 was charged to an operating expense account originally.

Q. What have you to say generally as to the propriety of including in cost components of such cost originally charged to operating expenses instead of being capitalized?

(Testimony of William H. Bell.)

A. I think I have already answered that question. I [30] intended that my remarks should apply to all proper component parts of cost regardless of their nature, whether materials, labor, or the overhead expenses of various kinds which are generally regarded as properly capitalizable.

Q. Would your answer be the same as to true components of cost, such as interest during construction, which may not have been charged at all on the books of the accounting company?

A. Yes, it would. As I see it, there is no essential difference between interest during construction and taxes and insurance during construction. As to the latter, the charging of the items to construction involves a credit to an expense account. As to interest, it involves a credit to an interest expense account or, what is practically the same thing, to a separate income credit account which in most cases I believe should, in an income statement, be shown essentially as a deduction from the interest expense.

The historical accounting treatment of any such item, or the fact that it may not have been recognized at all on the books of the accounting company, should have no effect whatever on the propriety of its capitalization as a true element of construction cost.

Q. Mr. Bell, if the records of an accounting utility company are such that it is impossible to determine from them the original cost of plant items

(Testimony of William H. Bell.)

for the purposes of the new [31] system of accounts, would it be necessary to resort to estimates?

A. No doubt it would. [32]

Q. Mr. Bell, I direct your attention now to page 14 of the Joint Report of the staffs of the Federal Power Commission and the Public Utilities Commissioner of Oregon introduced in this proceeding as Exhibit 3, and I call your particular attention to page 14 of this exhibit. I direct your attention, Mr. Bell, specifically to the fourth paragraph appearing on said page 14, which reads: "It is the opinion of the examiners that the reclassification of electric plant pursuant to Electric Plant Instruction 2 D was not intended to require or permit a reaccounting of a utility's construction cost. Consequently the entire amount of such interest [34] during construction has been scheduled for adjustment and reversed to Account 107, Electric Plant Adjustments."

Mr. Bell, what have you to say as to this expression of opinion on the part of the examiners?

A. It seems to me that the distinction between the words "reclassification" and "reaccounting" is metaphysical. At a matter of fact what the companies are called upon to do is to classify their electric plant as to the effective date of the system in accordance with the accounts prescribed in the system. As I have previously pointed out, the last sentence of Instruction 2 B interferes with the carrying out of the general instruction as to the classification of the plant in accordance with the detailed

(Testimony of William H. Bell.)

requirements as to determining original cost. Such determination of original cost can only properly and fairly be made by consideration of all elements of cost, no matter what their accounting treatment may have been at the time. [35]

Q. What have you to say, Mr. Bell, as to the propriety of including in the cost of utility plant items of interest during construction incurred in prior years but not capitalized?

A. The classification of accounts necessarily recognizes as a proper element of cost interest during construction which represents the net cost of borrowed funds used for construction purposes and a reasonable return upon the utility's own funds when so used.

In my opinion, the fact that interest during construction may not have been recognized as a part of cost at the time the plant was constructed does not constitute a good reason for excluding such charge in the reclassification of the property as of January 1, 1937, called for by the system of accounts.

Q. Mr. Bell, I call your attention to pages 3, 4 and 5 of the Answer of the Respondent in this proceeding and I call your attention particularly to the section of such answer bearing the caption "Organization of Respondent." Assuming that the organizers of Northwestern Electric Company rendered the promotional or other services there described in connection with organizing the company and putting it in readiness to do business, where, if

(Testimony of William H. Bell.)

at all, should the cost [36] of such services to the company, whether represented by cash or some consideration other than money, be recorded in the company's plant account?

A. It seems to me that it should be included in Account 301, "Organization." I suppose there is some possibility that it would as appropriately be included in Account 303, "Miscellaneous Intangible Plant", but the instructions rather favor the inclusion in Account 301, as that account seems to be intended to include all costs such as those incurred in putting the company in readiness to do business. [37]

C. W. PLATT,

called as a witness on behalf of the Respondent, being first duly sworn, testified as follows:

Direct Examination

By Mr. Laing:

Q. Will you state your name, and so forth?

A. C. W. Platt.

Q. Mr. Platt, what position do you hold with the Northwestern Electric Company?

A. I am the secretary and treasurer of the company.

Q. How long have you held that position?

A. Since March of 1925.

(Testimony of C. W. Platt.)

Q. What has been your experience in charge of accounting matters prior to the date when you became secretary and treasurer of the Northwestern Electric Company?

A. I had been a public utility accountant for 31 years. In 1912 I became assistant secretary and assistant treasurer of Portland Gas & Coke Company, and in 1924 I became secretary-treasurer of that company.

Q. And you became secretary and treasurer of the North- [41] western Electric Company at the time that that company, by the acquisition of the common stock by the American Power & Light Company, and when they came into management?

A. That is right.

Q. In your capacity as secretary and treasurer of the Northwestern Electric Company, what are your general duties and responsibilities?

A. I am chief accounting officer of the company.

Q. And the accounting staff of the company works under your direction and supervision, is that right? A. That is right. [42]

MR. C. W. PLATT

was recalled as a witness on behalf of the respondent, and testified as follows:

Direct Examination

By Mr. Laing:

Q. Mr. Platt, on page 14 of the Joint Report, the [83] examiners recommend a reversal of the charge to electric plant in the amount of $34,959.79; will you please explain this item?

A. This is interest during construction on specific electric plant construction charges during the years 1914 to 1924, inclusive, during which period interest was recorded on only a limited number of jobs, and through accounting error the recording of this item of cost was omitted entirely.

Q. We are speaking now, of course, about an item contained in the company's reclassification of account, which the examiners propose to reverse, is that true? A. We are.

Q. I understand that you wish to make a correction in connection with this item that has to do with the amount of the calculation, is that correct?

A. Yes. Subsequent checking of the job orders upon which this interest was calculated revealed that several of them covered property retired from service prior to December 31, 1936. Interest calculated on these items, and included in the total of $34,959.79 was $3,569.92. The correct amount, therefor, is $31,389.87.

(Testimony of C. W. Platt.)

Q. So that is tantamount to saying that you have the company's reclassification corrected in that amount and as to that item, is that correct?

A. That is correct. [84]

Q. How was this item calculated by the company in its report?

A. At the rate of 6% per annum on expenditures on these jobs.

Q. Is that in conformity with the Commission's classification of accounts?

A. It comes definitely within the provisions of electric plant instruction five (17).

Q. Which appears on page 42 of the pamphlet?

A. Which reads: "Interest during construction shall be charged to the individual job upon which the funds are expended."

Q. You didn't read the whole definition of that, Mr. Platt.

A. That whole section reads as follows: "Interest during construction includes the net cost of borrowed funds used for construction purposes, and a reasonable rate upon the utility's own funds when so used. Interest during construction shall be charged to the individual job upon which the funds are expended and shall be credited to account five (36), interest charged to construction credit. The period for which interest may be capitalized shall be limited to the period of construction. No interest charges shall be included in these accounts upon ex-

(Testimony of C. W. Platt.)

penditures for construction projects which have been abandoned."

Q. What reason did the examiners give in their joint [85] report for reversing this item or recommending its reversal?

A. They based this upon their opinion that electric plant construction to D is not intended to require or prevent reaccounting of a utility's construction costs.

Q. You stated, I believe, a moment ago that this item was originally omitted from the company's books through accounting error or omission. Do you find any place in the classification that accounts for or prohibits the correction of such errors?

A. I do not.

Q. In your opinion does the original omission of such item make it any less a true element of cost?

A. It does not. Inclusion of this interest is necessary to a proper statement of their cost.

Q. Were there any similar interest charges calculated in respect to the steam heating plant?

A. Yes, sir, in the sum of $2,060.47.

Q. What is the recommendation of the examiner with respect to that item?

A. The recommendation is the same as that pertaining to electric plant account.

Q. And are you as an accountant, Mr. Platt, of the opinion that these charges are proper elements of cost?

(Testimony of C. W. Platt.)

A. I am, and for the same reasons I gave with respect to charges of this character applied to electric plant just [86] referred to. [87]

Q. Will you please explain the accounting principles governing the determination of interest during construction.

A. There are various ways of computing interest during construction. A method sometimes used is to compute interest on monthly totals of accumulated charges to the construction account, other than interest, from the first day of the month following such expenditures to the end of the construction period. To the extent that interest was charged on the books of the company prior to the reclassification this is the method that was followed. In order to compensate for the fact that this computation does not allow for interest on expenditures during a particular month to the end of that month, an extra one-half month's interest on total expenditures for the current month is allowed by way of adjustment. Or another way of accomplishing this compensating adjustment sometimes used, is to add one-half month to the entire construction period for interest computation purposes. [95]

This method, including one or another of the compensating adjustments, is correct if all of the actual expenditures for construction are charged to the construction account at the time the expenditures are made. When this is the case, expenditures for the book-charges to the construction job are the

(Testimony of C. W. Platt.)

same, and a computation of interest on the basis of book-charges obviously reflects the true interest during construction. [96]

Furthermore, as I have testified previously, interest during construction has never been set up on the books covering expenditures on the smaller construction jobs, that is, those costing under $1,000 and not extending more than one month. Consequently, the adjustment for interest on the cash balances required for construction purposes and on the construction material inventories, corrects for the omission of interest during construction on such small jobs, which in the aggregate, represent a large sum of money. [97]

WILLIAM H. BELL,

recalled as a witness on behalf of the Respondent, having been previously duly sworn, further testified as follows:

Cross Examination

By Mr. Slaff:

Q. How many senior partners are there in the firm of Haskins & Sells, about?

A. I wouldn't know. I don't know just what the definition of senior partners would be. I am senior, pretty much senior, as to age. I am the third partner in Haskins & Sells out of about sixty.

Q. Sixty partners. A. Yes.

(Testimony of William H. Bell.)

Q. How many partners are there with responsibility as to the policy of the firm?

A. In a professional organization you could hardly draw the line as to what partners are responsible for the policy. We have a number of offices and we have a partner in each of them except two, I believe.

Q. How many offices do you have where you have at least one officer? A. Thirty-five.

Q. And in each one of those offices you have a partner, in each one of those offices except two you have a partner resident? [163] A. Yes.

Q. And each one of those partners has responsibility with respect to policy of your organization?

A. Well, he is charged with the responsibility of executing the engagements that are put in his charge. He doesn't have anything to do, necessarily, with making—carrying out general policies affecting the firm as I do, for example. I am in our so-called executive office and I have more than any other one partner to do with the establishment of general policy.

Q. And by general policies you mean with respect to general policies as they affect the accounting practices and the auditing practices of your firm? A. That's right.

Q. Now, how many of your partners are there who have similar responsibilities to yours in that connection?

(Testimony of William H. Bell.)

A. Well, there isn't any that have similar—there isn't any that have just the same. There are perhaps four or five that might be said to exercise somewhat similar functions.

Q. That is with respect to determining the accounting and auditing principles followed by your firm?

A. Of course it is a partnership and we confer, but naturally in as large an organization as ours we have to have a supervisory organization and comparatively few persons [164] do formulate the general policy.

Q. Well, will you tell us what is the responsibility of a partner in connection with the making of audits and certifications based thereon so far as those audits come under his supervision and direction?

A. To see that the audit is properly executed and that proper principles are observed in the doing of it, in giving our opinion with respect to the financial statement.

Q. In carrying out the general policies laid down by your firm, is that it?

A. That's right, and not only the general policies laid down by our firm, but those generally accepted by the profession.

Q. And of course your firm itself accepts the responsibility for the actions of its partners in that respect?

A. Oh, yes, partners and employees, as well.

(Testimony of William H. Bell.)

Q. Now, are the—tell me this, are the fundamental—all accountants don't have the same ideas, do they, with respect to accounting principles and accounting practices?

A. Well, there are variances, of course, sure.

Q. Between equally qualified accountants and auditors? A. Yes, indeed.

Q. And within your firm, I take it, there must be from time to time such differences?

A. Oh, yes, temporarily. [165]

Q. Then they are ultimately ironed out, is that right? A. They must be.

Q. In other words, as far as your firm is concerned the application of accounting principles and practices becomes a matter of firm policy and doesn't depend upon the individual idiosynerasies of the partners?

A. Well, that is our aim. Naturally, in the very extensive scope of our work touching upon all kinds of businesses and all kinds of problems there would be minor differences as to relatively minor matters, but as to all major matters we certainly aim to present a united front.

Q. As to fundamental components of cost, for example, you aim to present a united front, is that right? A. Yes.

Q. And does it present that kind of front?

A. Yes, I would say as to the real essentials. Now, no doubt you are driving up to this question

(Testimony of William H. Bell.)

of the uniform system of accounts and the uniform observance of the uniform system of accounts.

Q. I am sure we will get to that.

A. Well, perhaps I can beat you to it.

Q. Go right ahead.

A. As I said in my direct testimony, there are variations in the keeping of accounts by our clients and there may [166] very well be variations in the carrying out literally of the uniform system of accounts in the Federal Power Commission with respect to what one person might call principle and another person might call a detail. Certainly variations with respect to overhead as to the rate used, interest during construction with respect to the rate used—those things are what I characterize as minor.

Q. But whether or not a given expenditure is an element of cost and should be accounted for as cost you don't consider as a minor principle?

A. No, as a cost, as a class, we don't consider it minor, no.

Q. Would you consider that as a fundamental principle, a fundamental problem involved in meeting the classification in the uniform system of accounts of the Federal Power Commission?

A. Yes.

Q. Could you list for us, Mr. Bell, some of your major utility clients, firms?

A. Well, there is Electric Bond & Share group, Associated Gas & Electric group until recently, anyway——

(Testimony of William H. Bell.)

Q. You mean until the trustees took over?

A. Until the trustees took over in January, and I don't know how we are going to come out on that. That is to say, we have audited most of the companies in the [167] Associated Gas & Electric. We audit a great many of the companies and the holding company in the Standard Gas & Electric group. We audit the Pacific Gas & Electric Company, Pacific Lighting Company and its subsidiaries, the Consolidated Gas & Electric Company, I think it is, of New York, is the successor to what is left of the old Central Public Service group, and no doubt others around the country. Those are the largest systems I can think of.

Q. Duke Power, is that one of your clients?

A. No. I don't think so. Is that an independent company?

Q. Yes.

A. No, we don't do it, I don't think.

Q. Associated Gas & Electric, Standard, Bond & Share, Pacific Gas & Electric, Pacific Light, Consolidated Gas & Electric, those are the ones you have?

A. Those are the ones that come to my mind, yes.

Q. Has your—I presume your firm has consulted with various of those clients and discussed with various of those clients the requirements necessary to meet the Federal Power Commission's Uniform System of Accounts?

(Testimony of William H. Bell.)

A. Not to any great extent, because the—very few of them have put in their reports, or at least there hasn't been any final agreement on them, and we have not been consulted by the companies to any great extent with respect to [168] those requirements.

Q. Have you been consulted at all about them?

A. Well, I wouldn't know about that, about being consulted at all, but—we may have been consulted at all but it hasn't come to my attention particularly.

Q. Has it come to the attention of some other partner? A. Yes, somewhere.

Q. You don't—do you work on it yourself, have charge of any of these other systems, accounting and auditing work of your company, with any of the other systems than Bond & Share that you mentioned?

A. Well, I don't actively work on any of these. My work is entirely consulting and general supervisory.

Q. When were you first consulted in connection with the reclassification by Northwestern Electric Company of its accounts? A. I, personally?

Q. To meet the requirements of the Federal Power Commission? A. I, personally?

Q. Yes. A. About three weeks ago.

Q. And when was your firm first consulted in that connection? A. I don't know.

Q. Approximately. [169]

(Testimony of William H. Bell.)

A. I don't know. We have people working on the Electric Bond & Share job continuously the year 'round and I wouldn't know when the subject was first discussed with any of our people.

Q. Would you know when they first—when the subject was first discussed with any of your people in connection with the Electric Bond & Share system as a whole?

A. No, that is what I am talking about, no.

Q. Do you have an office in Charlotte, North Carolina? A. Yes.

Q. Who is the partner, resident partner, in charge there? A. Mr. O. N. Hutchinson.

Q. Hutchinson? A. O. N. Hutchinson.

Q. What is your per diem fee for your consultation with this company of the Bond & Share system, and in connection with your testimony?

A. Well, I am not—work of this character for one of our regular good clients such as the Electric Bond & Share group, my per diem fee is $100.

Q. You certainly wouldn't say, Mr. Bell, would you that the partners or accounting and auditing employees of Haskins & Sells were indolent or ignorant?

A. I should hate to think so. [170]

Q. And I'm sure you don't think so?

A. No, I don't.

Q. You don't think either, do you, that the present accounting officials and employees or the

(Testimony of William H. Bell.)

past accounting officials and employees in the last ten or fifteen years of Northwestern Electric Company are either indolent or ignorant?

A. No, I don't.

Q. They are all all right?

A. When I said that yesterday I had in mind the general industry, small companies—I have seen a lot of them, a great many of which have gone out of business or been absorbed in the large systems.

Q. Well, you realize that we are here concerned in this proceeding with Northwestern Electric Company, do you not? A. Oh, yes.

Q. Surely. Now, as a matter of fact, I think we would both agree, wouldn't we, then, your officials and employees' and the Northwestern officials and employees know their business and are hard-working people? A. Very definitely so.

Q. Now, you said that you had audited, or your firm had audited, the books of Northwestern Electric Company. Do you know for what period you have done so? A. Yes. [171]

Q. Will you please state the period?

A. We audited the accounts of Northwestern Electric Company under the old regime from 1915 to, I think, to 1925, and under the present administration, for the years 1932 to 1939.

Q. Now, you stated that, in your testimony, page 26, "No doubt the purpose of a uniform system of accounts for any particular industry is to effect standardization in order that a particular item in

(Testimony of William H. Bell.)

the financial statements of one company will be understood to be stated on the same basis as that of the same item of all other companies." You did so state, did you not? A. Yes.

Q. Now, it is equally desirable, is it not, that the financial statements of one company for one year be understood to be stated on the same basis as the financial statement of that company for another year? A. Yes.

Q. And might be stated in this way that it is highly desirable that accountants, both professional and private, endeavor as far as practicable to develop uniform procedure in the preparation of reports so that the reports of any one business for different periods may be readily comparable, and so that bankers, credit men and others may have no difficulty in contracting the facts as reported by the [172] different enterprises?

A. I agree to that.

Q. You recognize that as pretty good authority, don't you?

A. I don't know. That sounds all right. Did I write it?

Q. Bell, on Accounting Reports.

A. Sounds all right.

Q. Now, you stated also, did you not, Mr. Bell, your firm in advising all companies, all utility companies, with respect to classification of accounts, this account pursuant to the uniform system of ac-

(Testimony of William H. Bell.)

counts, would, I take it, give the same advice that has been given to the Bond & Share?

A. There isn't any doubt about it. Let me say this, please. Now of course we have a large organization, and it may be that some of our people in some part of the country might express a personal opinion one way, and some person somewhere else would express an opinion some other way. We aim, through our executive office in New York and largely through my own effort, to disseminate informatin regarding our experiences and ideas for the information and guidance, sometimes governance—maybe there isn't any such word—of our organization.

Now, when a thing becomes—when an issue, a question, [173] becomes important we will disseminate our views on it.

Q. Well, the question of restatement of overhead as attempted by Northwestern Electric Company in its reclassification of accounts is an important problem, is it not?

A. Very definitely is. Any anyone in our organization who hasn't had the opportunity to get all the facts and the basis for what I think is straight, correct thinking on this and goes off the deep end, we are going to tell him what we think about it.

Q. And I presume you have already done so?

A. Not yet to any very great extent. I am very frank to say, as I did say very frankly, we have not

(Testimony of William H. Bell.)

been called in by our public utility clients to any considerable extent, or not to the point that it was brought to my attention at all until this Northwestern Electric case. Then I was approached on it and I discussed the matter with six or eight of my partners in New York and we were unanimously of the same opinion so we have gone ahead.

Q. It is possible, and it is quite probable, is it not, that the accounting officers of some of your utility clients may differ with your concept as to restatement of overheads previously charged to operating expenses?

A. Oh, I suppose it is possible.

Q. Probable, too, wouldn't you say?

A. No, I think not. [174]

Q. You don't think that the accounting officers, responsible officials, accounting officials, of any of your utility clients—you don't think it is probable that they would differ in their conception from you and your firm with respect to this problem of restatement of overhead previously charged to operating expenses?

A. Of course that is rather idle speculation as to——.

Mr. Slaff: I move to strike that, Mr. Examiner, as not responsive. I might observe that I don't think it is idle speculation.

Mr. Priest: Now, if the Examiner please, it seems to me that the answer was responsive and a

(Testimony of William H. Bell.)

fair observation by way of reply to counsel's question——

Mr. Slaff: Oh, well, all right, then. I withdraw my motion to strike. Just go ahead and finish your answer.

A. Well, I mean as to what is probable in the minds of thousands and thousands of public utilities.

By Mr. Slaff:

Q. You don't have thousands and thousands of responsible accounting officials among your clients, do you? A. In the public utility industry?

Q. Among your clients.

A. Oh, I beg your pardon.

Q. Yes. Now just listen to the question. [175]

A. Pretty close to it. Now don't get so——

Q. All right.

A. Pretty close to it, yes.

Q. How many thousands of responsible accounting officials do you have among your public utility clients?

A. I don't know. A lot of them.

Q. Do you know whether you have one thousand? A. No.

Q. Do you know whether—

A. (Interrupting) We have a lot of them.

Q. (Continuing) Do you know whether you have five hundred?

A. Very likely, yes.

Q. All right. Now, then, let's confine ourselves to the accounting officials, the responsible account-

(Testimony of William H. Bell.)

ing officials of your public utility clients. Do you think it is probable, reasonably probable, that various of those officials will differ with you, with your company, with respect to your interpretation of the problem of restatement of overhead previously charged to operating expenses, in connection with meeting the Uniform System of Accounts of the Federal Power Commission?

A. The only way I can answer that is from my experience with the general viewpoints of public utility men, and I should say it is improbable. That is entirely a question [176] of opinion.

Q. Surely. It is your opinion, then, that it is improbable? A. Yes.

Q. Now, you stated that the companies are now called upon to state their property account on a new basis in accordance with a new concept of cost, viz., the cost of the property when first devoted to the public service. That is correct, is it not?

A. Yes.

Q. Well, as a matter of fact, as a concept of cost there is nothing new about that concept, is there?

A. As a concept of cost for accounting purposes I think it is, yes, in the recording of books. In recording on the books the cost of the property when first devoted to public service, yes. If properties have been bought as a unit, as operating units, and if there have been various changes in hands of property.

(Testimony of William H. Bell.)

I am not saying—I didn't intend to say that it is a brand new idea that, to determine the cost of property for one purpose or another, rate-making purposes or something like that, that you consider the original cost of the property when it was first built, whenever that was. But for accounting book purposes, I conceive it to be a new principle.

Q. Well, then, we can perhaps clear up when you did [177] say. Then we are in agreement that there is nothing new in utility accounting with the concept of cost as cost of property when first devoted to the public service.

A. I don't suppose—I think probably you and I are in agreement on it. I don't think there is any difference of opinion between us on that. As long as we are talking about it, I say that the companies are now required to classify their accounts for book purposes, for accounting record purposes. That is what I meant, in accordance with this idea.

Q. You can go right back to Smith vs. Ames, can't you and find the Court speaking of "Original Cost of Construction" as one of the elements that the Court spoke of there in the determination of value of utility property? A. That's right.

Q. And you can find that same concept running through practically all of the—I won't say practically all—many of the major utility decisions?

A. Involving rate cases and that sort of thing, yes.

(Testimony of William H. Bell.)

Q. And involving the fixing of rates, involving the properties of utility companies?

A. The valuation of the properties of utilities in connection with rate cases, rate proceedings. So far as I know, that is the only situation in which that idea has been advanced up until the promulgation of these new systems of [178] accounting.

Q. And even the very term "Cost of property when first devoted to the public service", or "when first brought into public service", that very term itself goes way back?

A. Yes, I believe it does, in connection with the public utilities generally but not the books.

Q. Are you making a distinction between constructed property, and acquired property?

A. Well, obviously there would have to be because as to constructed property there can be no difference. In other words, as property is constructed by the present owner it makes no—it is always devoted——

Q. (Interrupting) I see.

A. —assuming the company is always a public utility.

Q. Sure.

A. It makes no difference whatever if it is always devoted, the property that was constructed, if it was devoted to the public service when it was constructed. It is only in the case where a certain property has changed hands.

(Testimony of William H. Bell.)

Q. And with respect to Northwestern Electric Company, as far as that specifically is concerned, you say it had acquired no property other than by construction up to Decem- [179] ber 31, '36?

A. I believe that is the case, yes.

Q. Now, it is a fact, is it not, that under every system of accounting under which Northwestern Electric Company has operated to date it was called upon to state its property accounts on the basis of cost of the property when first devoted to the public service?

A. I think that is true. So far as I know, yes. I don't know how far back it was required to keep its accounts in accordance with the system of accounts, but I believe it is safe to say that under any system of accounts it was required to observe it was required to record its property at cost.

Q. And that would apply pretty widely to the industry as a whole, as a matter of fact, with respect to property constructed by the utility itself rather than property acquired by purchase or otherwise?

A. Yes, during the last few years, 1922 to 1925 on, generally.

Q. Yes. You are speaking from the—when you use the date 1922 you are taking the date of the adoption by the N. A. R. U. C. of its uniform system of accounts and its recommendation to the various state commissioners?

(Testimony of William H. Bell.)

A. That's right.

Q. Let me say, then, that we are in agreement, we [180] understand one another on that point with respect to the industry broadly and as a whole, you have said that as to property constructed by the utility the companies have been required to show the cost of that property when first devoted to the public service on their books, at least since, say, 1922 or thereabouts?

A. Yes, subject to this which is not very clear in my mind at the moment as to the precise language of some of the old instructions, but certainly the general instruction has been, since 1922 or thereabouts, that property should be carried at cost. And the classifications have enumerated their respective components.

Q. Yes. Now is there—now that you mention components, of course, is there any element or component of cost contained in any definition or instruction in the Federal Power Commission's uniform system of accounts that was not previously contained in the system of accounts under which Northwestern Electric Company operated?

A. I don't know for sure, but my—I have the impression that the present Federal Power Commission's uniform system of accounts is somewhat more definite in some things that the old N. A. R. U. C. classification.

Q. Well, we are all—just finish your answer.

A. I think I have.

(Testimony of William H. Bell.)

Q. Well, we will come to the question of definiteness [181] or lack of definiteness later on, but confining ourselves now to the term you, yourself, used, component of cost or element of cost, can you say whether there is any element of cost or component of cost now contained in any definition or instruction any place in the Federal Power Commission uniform system of accounts that was not previously contained in the systems of accounts under which Northwestern Electric Company operated?

A. I am not prepared to answer that question at the present. As I said a moment ago, I think that the old N. A. R. U. C. classification stated the components of cost but it is my impression that the subject is covered more, in greater detail and more definitely, by the present Federal Power Commission. I haven't done this very recently—I would have to set them side by side and compare them. I am frank to say, I haven't done it very recently.

Q. Didn't that consideration enter into your thinking on this subject prior to your testimony here, the question of whether there were new or additional components of cost in the present system of accounts as compared with the system of accounts under which Northwestern previously operated?

A. Not very much, because I was talking about —in my direct testimony yesterday morning on that subject—about the industry as a whole, and in-

(Testimony of William H. Bell.)

cluding properties that were built many years ago and acquired as operating units of [182] systems.

Q. Well, you realize, of course, that while you were speaking of the industry as a whole your testimony must be related to the specific problems involved in the Northwestern Electric Company in this proceeding?

A. Well, I leave that for the lawyers to argue.

Q. Well, you, as an accountant, know that the Examiners of the Federal Power Commission have a specific matter to decide here in connection with the Northwestern Electric Company?

A. Oh, yes, of course.

Mr. Priest: Counsel will endeavor to develop the relevance of that testimony, Mr. Examiner.

The Trial Examiner: Oh, I think perhaps the testimony will be tied in. However, I think at this point we will stand at recess for five minutes.

(Whereupon, a short recess was taken.) [183]

Mr. Slaff: I am advised by counsel for the Company that they have here a witness who they are very anxious to put on so that he may return to San Francisco at the earliest opportunity. I am perfectly willing that this witness be presented and that after his testimony is concluded I may proceed with my cross examination of Mr. Bell.

WALTER J. RENZ

called as a witness on behalf of the Respondent, being first duly sworn, testified as follows:

Direct Examination

By Mr. Gray:

Q. Please state your full name and place of residence?

A. Walter J. Renz, 901 Monterey Boulevard, San Francisco.

Q. What is your business or occupation, Mr. Renz? A. Certified public accountant.

Q. How long have you been a certified public accountant? A. Seventeen years.

The Trial Examiner:

Mr. Renz, will you keep your voice up as much as possible. It is rather difficult to hear you. [184]

Q. Where do you maintain your office?

A. The Standard Oil Building in San Francisco.

Q. Are you acquainted with Mr. Herbert Fleishacker? A. Yes, I am.

Q. How long have you known him?

A. It has been approximately since the year 1924.

Q. In connection with your work as a certified public accountant have you handled any business for Mr. Herbert Fleishacker?

A. Yes, I have.

Q. What is the nature of that business?

(Testimony of Walter J. Renz.)

A. I was first called into consultation in connection with a review of Mr. Fleishacker's income tax return for the year 1924. And I performed a like service for several years thereafter. I was called into consultation by Mr. Fleishacker in connection with the matter of the assessment by the Internal Revenue Department in connection with a deficiency in his Federal Income Tax from 1924 to 1929 inclusive.

Q. Was his profit in connection with the sale of his shares of the common stock of the Northwestern Electric Company involved in that assessment of a deficiency in his income tax?

Mr. Slaff: I object to that on the ground it is thoroughly irrelevant to this proceeding. [185]

Mr. Gray: If your Honor please, it is preliminary to the question of determining the value where stock is issued at other than cash, it is necessary to show the consideration for which it was issued. And it is only preliminary to furnishing later evidence of that value. Obviously we cannot prove the case all at once.

Mr. Slaff: Well, it is obvious that this is an attempt to prove value or claim of value as it affects Mr. Fleishacker, the value to him, which is irrelevant to this proceeding.

The Trial Examiner: The relevancy of the inquiry, of course, does not presently appear. However I see no harm——

(Testimony of Walter J. Renz.)

Mr. Slaff: I will withdraw the objection to the specific question.

The Trial Examiner: Very well.

Mr. Gray:

Q. What year's tax would that particular deficiency involve, Mr. Renz?

A. His income tax for the year 1925.

Q. When did he sell his common stock in the Northwestern Electric Company, if you know?

A. 1925.

Q. In his Federal Income Tax Return for 1925, what was the value of that common stock as stated by him as of [186] March 1, 1913.

Mr. Slaff: I object, Mr. Examiner, to that question because very definitely it is apparent at this moment that this has no releveney or materiality, outside of the fact that it is incompetent as well in this proceeding. The value to Mr. Fleishacker of stock in this company or any other company is not involved and cannot be an issue in this proceeding.

Objection joined in by Oregon Public Utilities Commissioner and Washington Department of Public Service and, after argument, sustained. [187]

Exhibits 16, 17 and 18 were at this time marked for Identification.

Mr. Gray: In view of Your Honor's ruling, I desire to prove and offer to prove by this witness

that he was acting for Mr. Herbert Fleishacker, who was the owner of a substantial number of shares of the common stock of the Northwestern Electric Company, representing him by virtue of a power of attorney from Mr. Fleischacker, and conducting negotiations on his behalf with the Bureau of Internal Revenue; that Mr. Fleishacker in his income tax return for 1925 had returned a value of this common stock as of $30.00 per share, as of March 1, 1913. [194]

That the Bureau of Internal Revenue questioned that value and conducted an independent investigation of this value of the stock and that this witness, Mr. Renz, conducted certain investigations on behalf of Mr. Fleishacker.

That these negotiations were conducted by Mr. Renz with Mr. C. E. Wild, Internal Revenue Agent in charge of San Francisco, and with the technical staff of the Bureau of Internal Revenue, and resulted in a stipulation signed by Mr. Renz, as attorney in fact for Mr. Fleishacker, which was delivered to the Bureau, signed under date of March 16, 1934, in which Mr. Renz, acting as Mr. Fleishacker's attorney-in-fact, agreed to a value of $22.50 a share. This agreement and stipulation has been marked Exhibit 16-A and 16-B for identification.

That agreement to stipulate was followed by a formal stipulation signed by Mr. Renz, as attorney for Mr. Fleishacker, in Docket No. 61957, then pending before the Board of Tax Appeals. The

stipulation on behalf of the Bureau of Internal Revenue was signed by Mr. Robert H. Jackson, then General Counsel for the Bureau of Internal Revenue, and now Attorney General of the United States.

That stipulation was submitted to the Board of Tax Appeals in Docket No. 61957 before that Board, which resulted in a decision of the Board, entered July 16, 1934, which fixed the amount of re-assessment due upon Mr. Fleishacker's [195] income tax return for the year 1935 in the sum of $13,907.04 for the tax year of 1925,—in the sum of $13,907.04, that amount including the deficiency in respect of Mr. Fleishacker's taxes on that common stock for the year 1925 still due over and above the amount which he had previously paid. He first stated $30.00, and negotiations were reduced to $25.00, then he paid additional taxes on the value of $25.00, and then in this proceeding before the Board of Tax Appeals the value was further reduced to $22.50 per share, and then this additional assessment was imposed on that changed valuation.

This agreement to stipulate, to which I have referred, was certified by the Chief Clerk of the Treasury Department, under the seal of the Treasury Department.

The stipulation itself, and the decision of the Board of Tax Appeals, are each certified by the Clerk of the Board of Tax Appeals, with the proper supplementary certificate, authenticating the Clerk's signature and the signature of the official who signed

the decision on behalf of the Board of Tax Appeals.

This offer of proof is with reference to the value of the common stock of the Northwestern Electric Company, as of March 1, 1913, as determined by an independent branch of the Government, and was made pursuant to the respondent furnishing other testimony to establish the value to the [196] company for the issuance of this common stock. As these exhibits I have had marked for identification may not be offered in evidence, then I will offer them as Respondent's Rejected Exhibits, in connection with the offer of proof.

Mr. Barton: We object to the offer on the grounds already stated.

Exhibits 16, 17 and 18 were thereupon marked as offered and rejected.

EXHIBIT NO. 16

Rejected

United States of America

Docket No. 17-5642

Treasury Department

Washington

July 17, 1940

Pursuant to the provisions of Section 661, Chapter 17, Title 28 of the United States Code (Section 882 of the Revised Statutes of the United States), I hereby certify that the annexed is a true copy of Agreement to Stipulate dated March 16, 1934, signed by Walter J. Renz, Attorney in Fact for

Herbert Fleishacker, San Francisco, California, on file in this Department.

In Witness Whereof, I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary of the Treasury:

[Seal] F. A. BIRGFELD,
Chief Clerk, Treasury
Department.

Agreement to Stipulate

C-TS:PJR
ELW

In re: Herbert Fleishhacker,
401 Second Street,
San Francisco, California.
Dockets: Nos. 61957 and 67324
Years: 1924 to 1929, inclusive.

The undersigned petitioner hereby agrees that he will stipulate with the General Counsel for the Bureau of Internal Revenue to the entry of an order by the United States Board of Tax Appeals redetermining his deficiencies in the above-entitled case on the following basis of settlement:

Net income shown in 60-day letters dated December 24, 1931 and June 14, 1932 to be modified as follows:

1. By treating the sales of stock through margin accounts as sales of capital assets in accordance with Sec. 208 of the Revenue Act of 1926 and Sec. 101 of the Revenue Act of 1928.

2. By computing the profit realized by the partnership M. & H. Fleishhacker in the year 1925 from the sale of common stock of the Northwestern Electric Company on the basis of a March 1, 1913 value of $22.50 per share for the 44,629 shares acquired prior thereto.

3. By considering the amount of $1,128,480.73 as the amount of profit realized by the partnership A. Fleishhacker & Co., upon the exchange on February 4, 1926 of 8,560 shares of common stock of Crown Willamette Paper Co. of Maine for cash and stock of Crown Willamette Paper Co. of Delaware.

4. By allowing to the partnership M. & H. Fleishhacker in the year 1927 a loss on liquidation of the Butte Valley Land Co., in the amount of $275,426.08, said amount to be considered as resulting from the "sale or exchange of capital assets" within the meaning of Sec. 208 of the Revenue Act of 1926.

5. By allowing to the petitioner in the year 1928 a loss on liquidation of the China Pacific Company in the amount of $20,008.10, said amount to be considered as resulting from the "sale or exchange of capital assets" within the meaning of Sec. 101 of the Revenue Act of 1928.

6. By allowing the petitioner a deduction from gross income for the year 1929 of a partially determined bad debt in the amount of $75,000.00 resulting from loans made to the Bulletin Publishing Co.

7. All other issues raised in the petition are to be waived by the petitioner and no new issues raised.

Subject to the approval of the Commissioner of Internal Revenue, the foregoing adjustments (together with such other adjustments as arise as a proper and necessary incident thereto) are agreed to as a basis for closing the case.

HERBERT FLEISHHACKER
By WALTER J. RENZ
Attorney in Fact

San Francisco, California,
March 16, 1934.

Filed at Hearing July 2, 1934
U. S. Board of Tax Appeals
EXHIBIT NO. 17
Rejected

Docket No. 61957

HERBERT FLEISHHACKER,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION

It is hereby agreed that there are deficiencies in Federal income tax due from this petitioner for

the taxable years 1924, 1925, and 1926 in the amounts of $4,794.50, $13,907.04 and $78,769.59, respectively. The Board may enter an order accordingly.

It is further agreed that effective upon the entry of the Board's order of redetermination, petitioner waives the restrictions, if any, contained in the applicable internal revenue act or acts, on the assessment and collection of said deficiency plus interest as provided by law.

(s) WALTER J. RENZ,
Attorney for Petitioner,

(s) ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue.

[Endorsed]: Filed at Hearing July 2, 1934. U. S. Board of Tax Appeals.

United States Board of Tax Appeals
Washington

United States of America
District of Columbia—ss.

I, B. D. Gamble, clerk of the United States Board of Tax Appeals, hereby certify the foregoing and attached to be true and correct copies of the Stipulation and Decision in Docket Number 61957, wherein Herbert Fleishhacker, is petitioner and the Commissioner of Internal Revenue is respondent.

In testimony whereof I hereunto subscribe my name and affix the seal of said Board of Tax Ap-

peals at the City of Washington in said District this 17th day of July, 1940.

B. D. GAMBLE
Clerk, United States Board of Tax Appeals.

United States Board of Tax Appeals
Washington

Docket No. 61957

HERBERT FLEISHHACKER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

I, C. Rogers Arundell, chairman of the United States Board of Tax Appeals, the same being an independent agency in the executive branch of the Government, do hereby that B. D. Gamble is clerk of said Board and was such clerk at the time of making and subscribing to the foregoing certificate, and that the attestation of said clerk is in due form of law and by the proper officer.

In testimony whereof, I do hereby subscribe my name at Washington, D. C., this 17th day of July, 1940.

C. ROGERS ARUNDELL
Chairman.

United States Board of Tax Appeals
Washington

Docket No. 61957

HERBERT FLEISHHACKER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

I, B. D. Gamble, clerk of the United States Board of Tax Appeals, do hereby certify that C. Rogers Arundell whose name is subscribed to the foregoing certificate, was at the time of subscribing the same Chairman of the United States Board of Tax Appeals, duly commissioned and qualified and that full faith and credit are due to all his official acts as such.

In testimony whereof, I have hereunto set my hand and affixed the seal of said Board at Washington, D. C., this 17th day of July, 1940.

B. D. GAMBLE
Clerk, United States Board of Tax Appeals.

EXHIBIT NO. 18
Rejected

United States Board of Tax Appeals
Washington

Docket No. 61957

HERBERT FLEISHHACKER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Decision

Under written stipulation signed by counsel for the parties in the above-entitled proceeding and filed with the Board on July 2, 1934, San Francisco, Calif., it is

Ordered and decided: That there are deficiencies in Federal income tax for the taxable years 1924, 1925, and 1926 in the amounts of $4,794.50, $13,907.04 and $78,769.59, respectively.

[Signed] LOGAN MORRIS
Member.

Entered: July 16 1934

Mr. Gray: I would like to correct one statement I made, to the effect that the offer was preliminary to the supplementing by other testimony. I desire this testimony, as offered, to stand on its own merits, as an independent determination by an independent

branch of the Government, independent of any other testimony the company may desire to offer with respect to the value of the stock.

The Trial Examiner: The Examiner, in disposing of the offer of proof, will sustain the objections that have been made to this line of inquiry.

Mr. Priest: Mr. Examiner, just one matter. May it be understood that each side takes an exception to any adverse ruling by the Examiner?

Mr. Slaff: As far as I am concerned, certainly.

The Trial Examiner: We follow, Mr. Priest, the new rule of our Federal Procedure, and you are automatically granted an exception. [197]

Mr. Priest: I rather assumed that was the case.

Mr. Barber: We add to that offer. The offer is not to show the value to the company at that time, but to show the value of the stock at that time, pursuant to the instructions of the Electric Plant Accounts of the Commission's System of Accounts. That is the criterion which controls. [198]

WILLIAM H. BELL,

Recalled as a witness on behalf of the Respondent, being previously duly sworn, testified as follows:

Cross Examination
(Continued)

By Mr. Slaff:

Q. Just returning to where we left off, Mr. Bell, before the recess.

(Testimony of William H. Bell.)

With respect to property constructed, rather than acquired by purchase or otherwise, confining ourselves to that and to the Northwestern Electric Company, can you state whether to your knowledge there is now any element or component of cost contained in any portion of the uniform system of accounts of the Federal Power Commission's Exhibit 6 in this case, which was not previously contained in the uniform system of accounts under which Northwestern operated? A. No.

Q. Does that mean there were no such other components or you cannot state now?

A. As far as I know, as far as I know——

Q. As far as you know there were not?

A. As far as I know there are no items of plant cost enumerated in the present system that were not in the previous N. A. R. U. C. system.

Q. And as far as you know, and if you don't know, we will tie this up with subsequent testimony, the system of [199] accounts of the Oregon Commission and the Washington Commission immediately preceding the presently effective system, were the system of accounts recommended by the N. A. R. U. C.? A. I believe they were.

Q. Now, you stated in your testimony at page 29 that "whether or not a certain expenditure represented cost of plant depends entirely upon its nature and purpose, and not at all upon its accounting treatment at the time." You so stated?

A. I did.

(Testimony of William H. Bell.)

Q. And when you stated this accounting treatment at the time you meant, I take it, the accounting treatment at the time of the expenditure?

A. That is right.

Q. Now, I think you stated earlier that there might be differences of opinion, reasonable differences of opinion between equally competent accountants, auditors, as to what constitutes elements of cost. Is that correct?

A. Yes, that is right.

Q. The ideas of one single individual may vary from time to time as to whether certain expenditures represent cost of plant, although the nature and the purpose of such expenditure remains unchanged. Isn't that so?

A. Well, of course one's ideas change as he—if he gets more light on the subject or if certain rules are impos- [200] ed upon him that he did not have before.

Q. Well, yes, exactly.

A. That is quite a generalization, I would say.

Q. Then, of course a plant, components of cost of plant, are not absolute concepts, are they; they are not immutable concepts?

A. I don't know anything that is immutable.

Q. Fine! Glad we agree on that! Now, referring back specifically to the concept of cost of plant, you would agree, of course, that these are not absolute concepts?

A. No, the world progresses.

(Testimony of William H. Bell.)

Q. And as you said earlier, the idea of a single individual as to what is cost may change from time to time, regardless of the nature of the expenditure? A. That is right.

Q. So that I think it is fair to say, in the light of that, is it not, that whether or not a certain expenditure represent cost of plant does not depend entirely upon the nature and the purpose of the expenditure?

A. Oh, no. I don't agree with your reasoning at all.

Q. You won't agree with that statement?

A. No.

Q. All right. Now, Mr. Platt, in the year 1935, let us say, had certain ideas, did he not, as to what constituted [201] cost of plant, of Northwestern Electric? A. That is right.

Q. And he expressed them, those ideas, in his financial statement? A. That is right.

Q. And your firm, certifying the financial statements of Northwestern Electric Company, agreed with those concepts of cost of Northwestern Electric plant? A. That is right.

Q. With respect to the four hundred and sixty-odd thousand of expenditures, Mr. Platt at least up until 1936 and possibly beyond that, did not believe that those were elements of cost of plant, did he?

A. That is right, he did not, apparently.

Q. Since that time he has changed his opinion on that score?

(Testimony of William H. Bell.)

A. He was told to change his opinion.

Q. Who told him to change it?

A. The Federal Power Commission.

Q. Does Mr. Platt then, to your knowledge, still believe that $460,577 of overheads for general and administrative expense previously charged to operating expenses and now contained in the reclassified plant account of the company does not represent the cost of that plant?

A. Well, I have not talked to Mr. Platt about it as [202] to what his state of mind is in respect to those things. I do not know.

Q. Haven't you discussed this problem with him at all?

A. Not that, as to what his belief is as to whether he was right before and continues to be right, or whether he is converted.

Q. Well, how about yourself? Do you think you were wrong before or haven't you changed your mind fundamentally on that subject?

A. All I have said, sir, is that the Federal Power Commission has required Northwestern Electric Company to reclassify its accounts on a certain basis; and that, in order to do so, it should not concern itself with the accounting treatment that was made at the time the expenditures were made, but should observe that present basis and standard system.

Q. You have also stated, have you not, Mr. Bell, that whether or not a certain expenditure repre-

(Testimony of William H. Bell.)

sented cost of plant depends entirely upon the nature and purpose of that expenditure?

A. I think if you would take it with the context it means what I said.

Q. Well, now, just a minute. Have you said that? Is that a correct statement of what you have said?

A. I insist upon answering that in my own way.

[203]

Mr. Slaff: Well, Mr. Examiner, I think I am entitled to know from this witness whether he did say what I have put to him as part of his testimony. When it comes to explaining his testimony, his able counsel will undoubtedly be able to furnish him with full opportunity.

The Trial Examiner: I think the witness is entitled to explain his answer, Mr. Slaff. I will allow the witness to answer the question in his own way.

Mr. Slaff: I am glad to have this explanation because I think — I am interested in getting it so that your Honor may observe the concept of this witness, fully spread upon the record, but I also think that when I ask him whether he made a statement during the course of his examination, I am entitled to have a yes or no answer to that so we can proceed from that and so the record will be complete on that score.

The Witness: Well, the only difficulty is that I am not antagonistic at all.

Mr. Slaff: I think we are getting along fine, Mr. Bell.

(Testimony of William H. Bell.)

The Witness: The only difficulty is, I do not want to set a certain sentence up isolated by itself, and separated from its context, and have any significance derived from that that should not be. Now, what I was talking about, cost as defined by the uniform system of accounts, together with the instructions to reclassify the accounts in accordance with such costs, and I meant to say—whether or not I said it [204] clearly—that it didn't make any difference in carrying out that program whether an item that would now be, and perhaps then, should have been treated as an element of cost, was charged to operating expenses or otherwise on the books at the time. If it should go in cost, then it is cost for the present purpose no less because at the time it was charged to operating expenses.

Q. Well, then, you could not and will not, then, make the statement, just as a statement, that whether or not a certain expenditure represents cost of plant depends entirely upon its nature and purpose and not at all upon its accounting treatment at the time of the expenditure?

A. Well, that is such a philosophical—doesn't mean much——

Q. It is your philosophy, Mr. Bell, not mine.

A. Well, I know, but, wait a minute! You are asking me to state something I never stated before.

Q. At page 29——

A. I know. I say, you are picking out one sentence.

(Testimony of William H. Bell.)

Q. All right.

A. Picking out one sentence. There were definite items as cost at that time. Mr. Platt, as I say, took the position that certain items which are now recognized in this reclassification as costs, were not costs. Now, it is possible for anybody to have said at the time you are wrong; [205] it is cost. But nobody did or didn't feel like doing it.

Within general limits, we allow our client to exercise a great deal of latitude in their determination of such things. So, it was not considered cost at that time. Now, it is quite possible that if you at the time would have said to me: "You are wrong. This is cost", that I would have agreed with you. What I was talking about then was according to present standards and instructions; and in connection with this reclassification it is cost regardless of how it was treated at that time.

Q. And you have said in your certificate, back before 1936, and Mr. Platt said in his statement, that the expenses totaling $460,770 were not costs of plant?

A. You mean inferentially?

Q. Yes. A. I certainly never said that.

Q. But that was the clear-cut inference and clear-cut deduction which anyone must draw from Mr. Platt's financial statement of the company's condition and your certification?

A. That is right. All we have certified is that

(Testimony of William H. Bell.)

these financial statements, with some exceptions and disclaimers which are not particularly germaine to this discussion, that the financial statement fairly represents the financial condition and results of operation.

Q. You have also stated that plant and property was [206] stated in the balance sheet of the company on the basis of cost as constructed?

A. That is right. We subscribe to their definition of costs. There is no question about that.

Q. And excluded from their definition of costs prior to 1936 were these elements which are now sought to be capitalized in this case?

A. That is right.

Q. Now, more specifically, up until quite recently Mr. Platt, and after at least January 1, 1937—Mr. Platt had assumed and believed that there were some $827,000 of cost element attached to this plant which he had previously considered to be costs? Isn't that so?

A. I don't know.

Q. Let me put it this way: You know that he has made a recalculation?

A. I had talked about it.

Q. Which he offered in evidence here as Exhibit No. 11?

A. I have heard him talk about it. I have more or less heard his testimony.

Q. Well, without pinning you down or ourselves down to the dollars involved, you are aware that

(Testimony of William H. Bell.)

up until the time he made the calculations involved in Exhibit 11 or decided that he should pursue the course that is illustrated in Exhibit 11, he had assumed, believed, that there were more [207] elements of cost in his plant than he now states?

A. I have been told that some clerical error was made. I am not familiar with the character of it.

Q. Well, let's pass that by. It is true, isn't it, that very few industrial companies capitalize interest during construction?

A. Yes, I think very few. There have been some that have come to my attention, but it is not customary in the industrial field.

Q. Isn't it equally true that very few industrial companies capitalize administrative and general expenses, also?

A. I don't think I ever heard of it being done, in industrial companies.

Q. So that——

A. (Interrupting) Of course, industrial companies,—I mean to say generally,—are not equipped to and do not do their own construction. They have other people that do it for them.

Q. Well, some of them do.

A. But generally they don't. They are not equipped the same way and they are not in the same kind of business at all—public utilities.

Q. Well, when they have someone else do their constructing for them, there is a certain amount of overhead [208] and general administrative effort

(Testimony of William H. Bell.)

devoted to that by the company officials themselves, to the supervision?

A. No doubt there is, but as I said before, I don't know of any case. None has come to my attention where that has been recognized in the accounts.

Q. Such expenditures are accounted for as expense items? A. Yes.

Q. The cost of plant which is constructed,—identical plant,—constructed for an industrial company which does not capitalize interest during construction, and which does not capitalize overhead expenses, may be stated differently, then, from the cost of plant of the company, let us say a utility company, which does capitalize interest during construction, and administrative and general expenses?

A. Yes, it may.

Q. And you can certify, quite properly, to a balance sheet which shows the cost of industrial plant "A" as a million dollars, without capitalization of these elements and also certify to the cost of an identical plant of utility "B", which shows $1,100,000, with capitalization of interest during construction, and overhead.

A. Yes, that is conceivable.

Q. Not only conceivable, but usual, in your certification? [209]

A. Oh, yes, granting your hypothesis that they are identical plants, all the rest of it, too.

Q. Certainly. A. Surely.

(Testimony of William H. Bell.)

Q. Now, let's briefly look at your statement from a slightly different point of view. You are familiar, I take it, with the accounting statement prescribed in the Uniform System of Accounts, and in practically all other accounts, for meters, are you not?

A. What do you mean?

Q. How are reset meters handled, accounted for?

A. I am afraid I do not. I read that, but I am hazy in my mind.

Q. Let me read it to you. It is very brief, "Operating Expense Account E 762-1." Do you have a copy of the system? A. What page?

Q. Page 127.

A. This account—Oh, I thought you were referring to some,—removing and resetting meters.

Q. Yes, that is right. A. I see.

Q. This expression, "This account shall include the cost of inspecting, testing, removing, resetting or changing the location of meters or instrument (illegible) transformers and [210] accessories and equipment located on customers' premises." And note "The cost of the first setting of a meter shall not be charged to this account, but to Electric Plant Account 350, Meters."

Now, let's assume 10 meters first set at $10.00 each. What is the cost of your Meters Account?

A. That goes into Electric Plant Account?

Q. Yes, the first setting.

A. It would be $100.00.

(Testimony of William H. Bell.)

Q. Now, in the year one the price of meters, let's assume, has gone up to $15.00 apiece, and you take out two of those meters and re-set them. What is the cost of your Plant Account Meters?

A. Merely re-set them and then restore them?

Q. Yes. A. Repaired——

Q. Remove old meters and put in two new meters.

A. Remove old meters,—discard them?

Q. That is right.

A. How many did we have? All ten?

Q. Two. A. Two of them?

Q. Yes.

A. Well, the two of them would be charged to capital account at $30.00. [211]

Q. Would they? A. I should think so.

Q. Under the system of accounts?

A. I should think so, yes sir.

Q. Now, suppose you re-set old meters, instead of removing meters.

A. The cost would all go to operating expenses.

Q. And suppose the cost involved in re-setting the meters were $5.00 per meter. What is your plant account?

A. It would pay out $20.00, with respect to those two meters.

Q. What is your whole plant account for meters?

A. Will we still have the original ten?

Q. That is right.

A. We don't have the substituted two?

(Testimony of William H. Bell.)

Q. That is right.

A. The plant account would still be $100.00.

Q. Now suppose you changed the method of accounting and cost involved in re-setting meters was charged to capital account, and you re-set the same two meters at the same cost, $5.00 each, what is the cost of your Meter Plant Account at that time?

A. You propound a question I was going to ask you. You made a statement $100 for the first installation. That, [212] I thought it would be understood that that would be for the primary cost of the meters without regard to installation labor, or anything like that, which might properly be capitalized, or any other incidental expense that might properly be capitalized, might run up the cost to another $100.00; but that would be the original installation, and I should think that from then on there should be no increase in that.

Q. In accounting for any units of property, the cost as stated on your books depends upon the accounting statement of the expenditure, does it not?

A. Oh, of course.

Q. And although the nature and purpose of the expenditure may remain the same, the cost stated in your books, in your capital account, may be different from time to time, depending upon your accounting treatment; is that correct? A. Yes.

Mr. Slaff: Is it all right for me to discontinue at this time?

(Testimony of William H. Bell.)

The Trial Examiner: I was just going to inquire, Mr. Slaff, if this would not be an appropriate time to recess.

Mr. Slaff: Very agreeable.

The Trial Examiner: We will stand at recess [213] until two o'clock.

(Whereupon an adjournment was taken until 2:00 o'clock this afternoon.) [214]

July 23rd, 1940.

Tuesday Afternoon. 2:00 o'clock.

Afternoon Session.

The Trial Examiner: The hearing will be in order.

WILLIAM H. BELL

resumed the stand for further

Cross Examination

By Mr. Slaff:

Q. Have you changed your mind since before January 1, 1937, as to what expenditures of the Northwestern Electric Company constituted cost of plant of that company? A. No.

Q. So that if the Federal Power Commission interprets its system of accounts in line with the interpretation suggested by the staff in the joint report, and finds that the overhead and similar expense previously charged to operating expense not capitalized are not proper elements to be now stated

(Testimony of William H. Bell.)

as cost of plant of Northwestern, it will not violate any conception of yours with respect to fundamental principles of sound accounting?

A. Well, as I have said, the only position I am taking in that regard is definitely, as I understand the instructions in uniform system of accounts, the Company is called upon to restate and reclassify its accounts, and undoubtedly there is some significance to it, and it is done for a reason. Very likely of importance to the Company in reclassifying its [215] accounts and creating an account debit or credit balance as the case may be if any in account 107. And that being the case it seems to me that the property in this process of reclassification should be put definitely on what is now, I will grant you, a proper recognized basis for capital charges.

Q. In answer to my question you got away and travelled from the question as I put it to you. Let us go over it again. You have stated before in your testimony your interpretation of the uniform system of accounts prescribed by the Federal Power Commission, Exhibit 6 in this case?

A. That is right.

Q. The question I put to you now, Mr. Bell, is this: If the Commission should differ from you as to interpretation of its system of accounts, and should interpret its system as not to allow the Northwestern Electric Company to capitalize now expenses previously charged to operating expenses, it will not violate your conception of sound accounting principles?

(Testimony of William H. Bell.)

A. Although I stated that I had no disagreement with the company's—with what the company did before in considering its certain expenditures to the cost of plant or operating expenses, we have now something that puts a different light on it. Previously we had nothing but cost of plant. We have now accounts 100.5 applicable in some situations and account 107. [216]

Q. Let me break in without destroying your continuity of thought, if I can, does account 100.5 apply to Northwestern Electric Company?

A. It does not. The only account that applies here is account 107. We have here in this situation then account 107 that undoubtedly has a great significance. I don't know just what. We know, of course, that the Federal Power Commission can direct the utility, The Northwestern Electric Company, to amortize or write off or otherwise dispose of accounts in 107. That has not been yet announced, but there is definitely a significance that there has not been before to the cost of utility property in view of this account No. 107, and therefore, I think, we have a different situation that makes it necessary to consider as never before what goes into cost.

Q. Do you know whether Northwestern Electric Company has changed its method of accounting for general and administrative expense since January 1, 1937, when the Federal Power Commission's system of accounts became effective?

(Testimony of William H. Bell.)

A. This whole matter is generally understood to be in a state of adjustment commencing as of January 1, 1937, and certainly I should say that the property accounts as of since January 1, 1937 will be stated on the books on the same basis as the property accounts as of January 1, 1937.

Q. Then tell me this: if the Federal Power Commission [217] should approve the reclassification as made by the Company, would you recommend to the Company that it should restate its property account or the fixed capital account for the years 1937, 1938, 1939, and so far in 1940?

A. Very definitely.

Q. You would? A. Yes.

Q. Now to return back to where we started from, can you tell me whether it will do violence to your conception of fundamentally sound accounting principles, if the Federal Power Commission should differ from you with respect to your interpretation of its system of accounting and should agree with its staff as to its staff's interpretation?

A. Well it would, yes, considering all the ramifications of these instructions. If we had not had accounts No. 100.5 and 107, had it not been just a question of the proper determination of book accounts or the costs of the company without the new significance to that cost that I say is inherent in this system in my opinion, then I would answer your question that it would not do violence, but——

Q. Well, as far as the Northwestern Electric

(Testimony of William H. Bell.)

Company is concerned, what new significance is there in the system of accounts as to the determination of cost of its plant?

A. Merely that the Company is called upon to make a reclassification of its accounts in accordance with this [218] system to put in balance debit or credit as the case may be in account 107; that is all.

Q. Well, it is required to show the cost under the new system of accounting, the Federal Power Commission's system, the cost of its plant, is that right.

A. That is right.

Q. And the detailed plant accounts of the Company are to be stated on the basis of cost to the Company of plant construction by it?

A. That is right.

Q. And that is the way the Company has been required to state its cost on its books pursuant to the previous systems of accounts by which it has been governed, isn't that true?

A. That is right, substantially, yes.

Q. Now let us turn for a moment to the question of determination of cost in another aspect. Let us assume that we want to determine the cost of a hogged fuel pile. Let us assume that there were bought a thousand units at fifty cents a unit and placed in storage. And let us assume that thereafter there were a thousand units at $1.50 a unit delivered.

(Testimony of William H. Bell.)

Now after the 2,000 units were assembled 500 units were withdrawn what is the cost of that pile of fuel?

A. Do you want me to get into a discussion of the relative merits of the average cost, first in first out, or last in first out, because——[219]

Q. Oh, I don't want you to discuss the merits of any of those methods. I am asking you to calculate it, if you can, on the basis of the facts that I have stated to you, which facts include the nature and purpose of the expenditure, to-wit fuel for the utility.

A. That involves the question of——

Q. Now I am asking you to tell me the cost of the remaining 1500 units?

A. When was the 500 taken out? After the second 1000 was put in?

Q. Yes, after the entire 2,000 was put in.

A. Do you mind if I get a pencil?

Q. Let me shorten it, then, this way——

A. Because it all depends—I don't know that this has any bearing on the case—as to whether you take this on an average cost basis, or whether you take it on a first in and first out basis. I presume in this case you would not take any in on a last in first out basis. There would be no reason for it, but you would take it probably on an average cost basis.

Q. That is it exactly. I think you have the point that I am driving at, Mr. Bell. The cost of that

(Testimony of William H. Bell.)

fuel pile depends on the accounting treatment in the removal from the fuel pile, doesn't it?

A. Yes, but the book value and the charge to operating [220] expense obviously depends upon the adoption of several alternative methods.

Q. Certainly. A. Yes.

Q. You could adopt, as you said, the first in first out method? A. Yes.

Q. You could adopt, as you said, the last in, first out method? That is right? A. Yes.

Q. And the way I figure it, you would have a cost of $750.00, or you could adopt an average cost method?

A. I think you are wrong in the $750.00, but that is all right.

Q. I misread my notes. I agree with you. It should be $1750.00. On the last in first out basis I find the cost would be $1250.00. On a basis of average cost I get a figure of $1500.

A. That sound about right.

Q. So that we can agree, I take it, that the cost of that fuel pile depends on the accounting treatment with respect to the cost of the fuel which was removed from the pile? A. Yes.

Q. Now the cost of utility plant, coming from [221] cost of operation of the storeroom of the utility would also depend, would it not, on the accounting treatment of stores?

A. No doubt, to some extent, yes, that is a fair statement.

(Testimony of William H. Bell.)

Q. And you would get different costs if you used different methods of accounting for stores from time to time? A. Yes.

Q. Other circumstances being the same?

A. Yes.

Q. And more than one method might be a perfectly sound and proper method of accounting?

A. That is right.

Q. Now you stated also in page 29 of your testimony that "Previously, the companies, whether or not they were subject to regulatory authority, exercised considerable discretion and in some cases, no doubt, failed to exercise due care as to the accounting treatment of expenditures which might have been capitalized; in fact, it may safely be said that until comparatively recently there was no well defined, authoritative statement as to what items should be capitalized, and there can be no doubt that many capitalizable expenditures were charged to expense accounts through ignorance or through sheer indolence." Now I think we agreed this morning, did we not, that capitalizable expenditures were not charged to expense accounts in the case of the Northwestern Electric [222] Company through ignorance or through sheer indolence?

A. That is right.

Q. Now when you say "it may safely be said that until comparatively recently there was no well defined, authoritative statement as to what items

(Testimony of William H. Bell.)

should be capitalized," to what are you referring as the "well defined, authoritative statement as to what items should be capitalized"?

A. Well, perhaps that was an unfortunate expression. I don't retract it, but I want to explain. Until comparatively recently is a state of mind depending upon one's age and experience, you know. To me the last fifteen or twenty years seems comparatively recently, and I was thinking, of course, along rather general lines—not applying particularly to the Northwestern Electric Company, but applying to properties built years and years ago which may have been acquired as an operating unit of the system. And it is a fact, as I stated this morning, that since 1922 and 1925 there have been pretty definite standards.

Q. Well then with respect to the items that should be capitalized, there was, prior to the adoption of the uniform system of accounts, so far as Northwestern Electric Company was concerned, more than one "authoritative, well defined" statement as to what items should be capitalized, namely the Washington system of accounts and the Oregon system of accounts under which the company operated? [223]

A. That is right.

Q. So that in the period for which the company now proposes to capitalize expenses previously charged to operating expenses, these well defined, authoritative statements as to what items should

(Testimony of William H. Bell.)

be capitalized did exist and the company operated pursuant to them?

A. Well, the company did not operate pursuant to them evidently because the company chose to disregard some of the provisions with respect to charging—not charging, overhead expenses and interest, I believe, to construction, when the classification of accounts said that they were elements of accounts.

Q. You certainly do not mean to say, I take it, Mr. Bell, that the company violated the Oregon system of accounts or the Washington system of accounts in its operations, say, from 1926 through 1936?

A. I think that is too strong a word. The company chose in the interest of conservatism to not avail itself of the permission or instruction, if you will, in the classifications of accounts, existent at that time, believing no doubt, as we as auditors believed, that whatever sin there was was certainly not material, was doing nobody any harm, and they were the sufferers, if anybody, and that is one of the things that I talked about this morning and I talked about in my direct examination, I think, about exercising discretion [224] within general limits of propriety.

Q. Having been conservative in the past you do not want to turn radical on us now, do you? I will withdraw that.

(Testimony of William H. Bell.)

A. Well, "radical" is not a very good word.

Q. Less conservative?

A. Even "liberal" is not a very good word. If it had not been for the instruction for a reclassification of the accounts and the creation of account 107 with whatever significance that may have for them in the future, I certainly would not have recommended that they change their practice because I temperamentally am conservative myself.

Q. Well then is it only because of the existence of account 107 and the possible significance inherent therein with respect to this company that you have recommended such reclassification and restatements as the company have made?

A. It boils down to just that, as far as I am concerned, yes.

Q. Now with respect to the Company's operation between 1926 and 1936, say, operating under the well defined and authoritative statements of the Oregon and Washington Commissions I think you said the company had a range of discretion,—the company officials had a range of discretion as to whether certain expenses were to be capitalized or charged to operating expenses?

A. Well, in any event they just about exercise that [225] discretion. I don't know whether it was with the acquiesence or tacit consent of the Oregon and Washington commissions. I don't know anything about that, but in any event they just about exercise that discretion.

(Testimony of William H. Bell.)

Q. Well, under the system of accounts which was the same as the NARUC — the 1922 system, they had the right and privilege to exercise that discretion, didn't they?

A. Well, I don't know. It is my recollection that the 1922 NARUC classification said the cost shall include a portion of the general expense substantially just the same as the 1937 Federal Power Commission. [226]

Q. Well, let me put it this way, then: You know that many companies operating under the NARUC classification as adopted by and adapted to different states, many companies did exercise exactly that same type of discretion?

A. Of course they did.

Q. And of course the discretion which the company exercised or which other companies exercised had a bearing, did it not, of importance up on the rate payers of the company?

A. Theoretically, it might have had some, practically, I think negligibly, if at all.

Q. Well, are you speaking generally, or with special reference to the Northwestern Electric Company?

A. Well, I am speaking from my knowledge of the Northwestern Electric Company, and pretty generally.

Q. Well, confining it——

A. (Interrupting) I wouldn't say invariably, because I think there have perhaps been some cases

(Testimony of William H. Bell.)

where there have been fairly precise determinations of rates based upon book cost of property, exclusive of reconstruction costs new, and actually getting down to brass tacks on their net income, there have been some of them that under certain franchises they have—franchise tax consisting of practically paying a portion of their net [227] income to the City or what not,—there may be some exceptions, but in my opinion rather few.

Q. Well, looking at it from the point of view of the operating expenses of the utility, a fundamental determination in a rate case is a determination of the operating expenses of the utility involved, isn't it?

A. Among other things, yes.

Q. Well, that is one of the fundamentals?

A. Yes.

Q. And if in the exercise of its discretion the Northwestern Electric Company, in a given year, decides in its best judgment to charge $100,000 of overhead to operating expenses instead of to Plant Account, that $100,000 represents an item that must be covered by the company's over-all rates?

A. Well, you have got to consider the effect on the property account, too, and their depreciation or retirement provisions, all wrapped up in it. That is why I said theoretically,—theoretically this is a matter of importance as to whether they have recovered their operating expenses from the public,

(Testimony of William H. Bell.)

in rates. It is only in those cases where there has been a precise determination. And, also, I should say the question of the rate actually earned is significant in that respect.

Q. Well, let's take up for a moment these other ele- [228] ments that you have mentioned, and let's assume that a company in the past has earned a fair return upon whatever may be a fair basis, and however the method of determining the fair basis,—whatever that may be. Now, assume that in the past it has charged $100,000 to operating expenses which it now seeks to capitalize. It has already recovered that $100,000, has it not?

A. Well, I assume so.

Q. Under the premise I gave.

A. Under your premise, yes, I understand.

Q. Now, if it is permitted to capitalize that $100,000, it will recover that $100,000 again by charging depreciation expenses, will it not?

A. I don't follow you.

Q. Well, the $100,000 will go into Plant Account, will it not?

A. But it does not come out of Plant Account. I mean to say it stays in the Plant Account. As far as I know, there is no disposition on anybody's part to put this in Capital Account or credit it to surplus or anything of that sort, and depreciate it. It is within the Plant Account; it is just a reclassification, setting up certain accounts.

(Testimony of William H. Bell.)

Q. Let's see. If you are going to take that $100,000 and you are going to distribute it over, say, ten different primary accounts. Is that right? [229]

A. Yes.

Q. $10,000 in each, say. A. Yes.

Q. And year by year, as you continue the operations of your company, you are going to make certain depreciation charges for each account, aren't you? A. Yes.

Q. Will the charge that you make depend upon the dollars in the account?

A. Previously—You are assuming now that there is a more or less scientific basis for depreciation?

Q. No, I am not, Mr. Bell.

A. All right, then. I say by——

Q. (Interrupting) I am assuming that your rates for depreciation remain the same after you have capitalized these dollars as they were before.

A. Of course if they had capitalized the dollars before, they may or may not—theoretically they would have increased their depreciation provisions, —maybe not to the same extent that they failed to capitalize.

Q. We will get back to that, if you want to go back to that later on, but let's stay for the moment with the problem that I gave to you. Isn't it true that the company, having once recovered this $100,000 by charging to operating expenses, will again

(Testimony of William H. Bell.)

recover the same $100,000 by charges to [230] depreciation expenses?

A. I don't think so, necessarily. What becomes of this amount that is now capitalized? Is it put in a credit adjustment account?

Q. There is added, in the problem we were considering, Mr. Bell, you added to your fixed capital account ten primary accounts, $10,000 against each one of those accounts. Now, how is the company going to determine its annual depreciation? What dollar amount of its annual depreciation——

A. (Interrupting) But I asked you——

Q. (Continuing) ——it is to include in the next year?

A. But I asked you in your hypothesis what becomes of the credit of $100,000.

Q. Well, suppose you make whatever assumption you choose at this time, as to what becomes of that.

A. All right. We will say it becomes a credit in Account 107. Does that change the total? It does not increase the total plant at all, and I can't see that there would be any excuse for taking any increased amount of depreciation.

Q. You would not, then, suggest transferring that credit to surplus at any time in the future?

A. No, I would not. [231]

Q. Well, why not?

A. Well, because, as I said before, I am by nature conservative, and I think there is just enough to the point you have in mind about the iniquity,—

(Testimony of William H. Bell.)

you probably consider it,—of the misstatement of their operating results in prior years, coming along now and correcting it.

Mind you, I don't say it is iniquity. I think this is just a re-classification within the Plant Account. But there have been some people, in talking about this thing, think it is just criminal to upset past years' operating results this way. I don't share that view, but I think there is enough to it so that I certainly——

Q. You recognize the view which may regard such a situation as iniquitous, not to say criminal, as perhaps the sound view of one who has equally sound ideas with respect to fundamental accounting principles as your ideas: simply a difference?

A. In degree.

Q. Yes, in degree, and a reasonable difference between two people, looking at the problem from different points of view, both aiming, let us say, at a fair result? A. Yes.

Q. Now, in addition, this company will be receiving, will it not, a return upon this $100,000 that has been [232] re-stated?

A. You are assuming that there is going to be an upward revision of rates, then after putting this $100,000 into capital account?

Q. Well, I am assuming that the company is going to earn a fair return upon the fair value of its property, after the $100,000 is added to the capital account.

(Testimony of William H. Bell.)

A. Of course it is not added to the capital account. It is added to certain detail capital accounts within the general group of the plant, and it doesn't change the total one iota.

Q. Well, do you say, then, that the company will—on my assumption—will recover no more in rates after the adjustment than it recovered prior to the adjustment or that it will be entitled to recover no more than it was recovering before?

A. If it was making a fair return on its plant investment before, this process of putting things up in certain detail plant accounts and crediting adjustment accounts so that the total remains the same, does not entitle them to make any more than it did before, in my opinion.

Q. Well, will the figure of total fixed capital be the same after the re-statement as it was before the restatement?

A. That is my understanding of it, that Account 107 [233] is part of the fixed capital.

Q. Well, will the Electric Plant Account, 100 through 100.6, the total of those accounts be the same after their statement as before the re-statement? A. I think they will be higher.

Q. And in the example which we have been discussing, they will be higher by $100,000, in the total?

A. Yes.

Q. Now, with respect to the so-called, well-defined and authoritative statement as to what items

(Testimony of William H. Bell.)

should be capitalized, the accounting employees and accounting officers of the company have had those authoritative and well-defined statements within the company itself, have they not, since——

A. (Interrupting). I don't know what you mean. Their own rules or the regulatory rules?

Q. In their own rules. They have defined carefully what should be charged to construction, what should be capitalized and what should be charged to operating expenses.

A. This Northwestern Electric Company has certainly since it was acquired by the American Power & Light Company, yes.

Q. That would be since 1925?

A. 1925, yes. Now, of course I will have to modify [234] that. I did not know, was not familiar with the system of the companies and their practices prior to 1932, but I should say that it is altogether likely that as far back as 1925 they had with their own organization well-defined and authoritative practices. I like those words.

Q. And those well-defined and authoritative practices referred to the items which should be capitalized and those which should be charged to operating expenses?

A. Yes. Now, I will have to say this, by the way of possible modification. I don't know how much discretion was exercised by local managements of companies controlled by, let's say the

(Testimony of William H. Bell.)

American Power & Light Company with respect to this matter. Certainly during all the time—I don't know just what you are driving at in your question, but I will have to make that reservation.

Q. The question is complete in itself, Mr. Bell. I have no ulterior motive.

A. Oh, I wouldn't accuse you of having an ulterior motive at any time.

Q. Had you completed? A. I think so.

Q. I think we agree then as to the fact that the company within itself had the well-defined practices which it followed? A. Yes. [235]

Q. The practices of the Northwestern Electric Company did not depend on the idiosyncrasy of accounting individuals connected with the company?

A. Well, it might have, you know.

Q. Well, did it?

A. That is what I meant when I said I did not know whether Northwestern Electric Company, for example, was following the same practice as other subsidiaries of the American Power & Light Company. It might very well be that Mr. Platt, for example, or the other officers of the Northwestern Electric Company, had peculiar ideas about these things that some of the other American Power & Light Companies didn't have. I am not at all sure they didn't.

Q. When you say "peculiar" I take it you mean "peculiar" as "different"?

(Testimony of William H. Bell.)

A. Not in the sense of "weird"—in a sense like that; peculiar to themselves.

Q. Different from others?

A. Distinctive.

Q. That is better. Now, of course you say you don't know, you haven't checked back?

A. No, I don't.

Q. But even if Mr. Platt's ideas as chief accounting officer were different from those of the chief accounting officers of the American Power & Light System, or differed [236] from the chief accountant's ideas,—of the chief accounting officers of individual subsidiaries within the system, once the practices of the company were defined and stated in accounting circulars that went out to the accounting employees, then the employees followed or attempted as best they could to follow those instructions? A. I have no doubt of it.

Q. And whether a subordinate official or employee liked the instructions or didn't like the instructions, he attempted to follow them to the best of his ability? A. I have no doubt.

Q. Now, you said at page 30 the following: "The Federal Power Commission has now set up rules for the determination of cost and original cost. There should not be one rule applying to property constructed prior to 1937 and another for that constructed since." You so stated? A. Yes.

Q. Now, confining ourselves to the Northwestern Electric Company, what is the different rule,

(Testimony of William H. Bell.)

if any, that applies with respect to property constructed after 1937 as compared with property constructed prior to 1937?

A. Well, what I meant by that is this: I think there should be no doubt whatever that in view of the instructions in the uniform system of accounts with respect to the reclassification as to the detailed plant account and the [237] creation of Account 107, if any, that the company would hereafter capitalize everything that is customarily capitalized or that it should capitalize, and that it should be allowed to put its accounts as of January 1, 1937, on the same basis.

Q. Well, you were speaking of rules applying to property constructed prior to 1937, and those rules applying to property constructed since?

A. Well, what I meant by that was this, that Instruction 2-B precludes the statement of the properties as of January 1, 1937, on the same basis as I assumed they would be followed at the beginning of January, 1937.

Q. Well, with respect to the rules that govern charges which the company might make to fixed capital prior to 1937, operating under the Washington and the Oregon systems of accounts, are they not essentially the same as the rules which apply now, as far as charges to fixed capital accounts are concerned?

A. Yes. I have already recited that, that practically there is no difference between the require-

(Testimony of William H. Bell.)

ments of the Oregon and Washington classifications prior to January 1, 1937, and the Federal Power Commission since. As I say, the only significance at all is based upon the assumption that beginning January 1, 1937, all proper elements of cost will be put in the property and therefore the statement of [238] the property as of January 1, 1937, ought to be on the same basis.

Q. Well, aren't you saying in effect, Mr. Bell, that the company officials propose to exercise their allowable discretion in a different manner after January 1, 1937? Therefore, they should be allowed to restate their capital accounts? A. Yes.

Q. And therefore they should be allowed to restate their previous exercise of discretion?

A. Precisely.

Mr. Slaff: I think, if it is convenient to the Examiner, this might be a good time for a recess, which I was taking anyway.

The Trial Examiner: Very well, we will take a recess of five minutes.

(Whereupon, a short recess was taken.) [239]

(Following a short recess the following proceedings were had.)

The Trial Examiner: The hearing will be in order.

Mr. Slaff:

Q. Mr. Bell, some time before the recess you and I were discussing the question of the annual

(Testimony of William H. Bell.)

depreciation charge with respect to restated amounts in capital accounts, you remember? A. Yes.

Q. Now it is not your opinion, of course, that account 107 is a depreciable account?

A. I would not want to say that categorically. It depends upon what is in it.

Q. Well, do I understand you to interpret the system of accounts—that is to say the Federal Power Commission uniform system of accounts, exhibit 6 in this case to mean that account 107 may be a depreciable account?

A. Well, let's see what we mean by "depreciable".

Q. An account on behalf of which any charges for depreciation may be made?

A. Are you drawing a distinction between depreciation and amortization?

Q. I am speaking of depreciation as defined in the Federal Power Commission uniform system of accounts, account [240] No. 503?

A. Applying to physical property only?

Q. Well, as the system of accounts states it may be applied?

A. No, it would not be depreciable in that sense.

Q. So that with respect to the $100,000 which we were discussing in our illustration, that went into the primary accounts, in account No. 100.1 "Electric Plant and Service" and assuming that the rates of depreciation remains the same after the restatement of accounts as they were before, the util-

(Testimony of William H. Bell.)

ity company would recover that $100,000 by charges to depreciation, account 503?

A. Well, I will have to correct or amplify what I said a moment ago. A debit balance in account 107 is what I was thinking of when I was answering would not be depreciable, but I think a credit balance in account 107 which was created by charges against the other electric plant accounts should be taken into consideration.

Q. What authority do you find within the system of accounts for that,—Exhibit 6?

A. No express authority except that the—it says Paragraph "B" of the instruction on account 107, "the amount included in this account shall be classified in such manner as to show the nature of each amount included herein, and shall be disposed of as the Commission may approve or direct." [241] I would think that a credit balance in account No. 107, which was created by additions to the other electric plant accounts should be amortized more or less in proportion to the depreciation, or amortization of the electric plant account.

Q. Then you are saying that there would have to be a specific direction by the commission, or specific approbation of the scheme of amortization set up by the company with respect to the credit account 107? A. Yes, it would seem so.

Q. Now if the Northwestern Electric Company had not restated its accounts in the manner it proposed at this time, but had continued to exercise

(Testimony of William H. Bell.)

the discretion which it had in the same manner as it had previously to January 1, 1937, would you certify to the correctness of the practices of the company?

A. I don't know. I don't know. I don't think I can answer that question. I would have to consider everything that had happened in connection with the restatement of the account when they got all through and it was accepted by the Federal Power Commission and the state commissions as to what would be the correct procedure there. If the company reclassified its accounts without consideration of these overheads, and so forth, which were not capitalized at the time and such reclassification was accepted by the commissions, [242] I doubt very much if we would be in a position as auditors to take exception to it.

Q. I asked you if the company did not restate—had not restated its accounts in the manner now proposed, but had continued to account both for plant operating expense after January 1, 1937, as it had accounted prior thereto, would you certify as to the correctness of the practice of the company?

A. Well, of course, as a matter of fact we have, you know, subject to the facts as it has been indicated, that the property accounts were in process of reclassification. As I understand now, you mean if this question of reclassification had not come up at all?

(Testimony of William H. Bell.)

Q. No, not if uniform system of accounts of the Federal Power Commission had not been prescribed, but if the Federal Power Commission uniform system being prescribed as it was, effective January 1, 1937,—if thereafter the company had not sought to restate or reclassify its property accounts in the manner which it now seeks to do, would you certify as to the correctness of the practices of the company?

A. Well, I think I answered that question. So that we are sure we understand each other, I will try again. I think what you mean is, would we continue to certify after there had been a reclassification or a statement that [243] there was no reclassification necessary?

Q. The latter.

A. The statement that there was no classification necessary?

Q. A statement by the company?

A. That is what I mean.

Q. That is right.

A. Accepted as such by the commission?

Q. That is right.

A. I don't see how, as an auditor I could have any grounds for declining to certify the account.

Q. The answer then is "Yes" to the question I previously put to you?

A. Yes, with all of those—all of those explanations.

(Testimony of William H. Bell.)

Q. Well, I don't think those explanations are qualifications is what I mean.

A. No, I don't think they are qualifications at all.

Q. You have, for example, issued a certificate for the year ending December 31, 1937, to the effect that in Haskins & Sells opinion, the company balance sheet and the latest statement of income and earned surplus of the Northwestern Electric Company, with their foot-notes, fairly presented in accordance with the accepted principles of accounting, consistently followed by the company, its financial condition as of December 31, 1937, and the results of its operations for the 12 months ended [244] that day. I am referring to——

A. Yes, I know, yes, that is right. The balance sheet—that of course is subject to a reservation regarding the adequacy of the retirement reserve.

Q. Yes, of course.

A. But it has reference to certain foot notes of the balance sheets and statements of income and surplus which are not particularly germane to the subject.

Q. And those balance sheets and income statements so certified have been submitted to regulatory authorities and investors, and so on?

A. Well, you say regulatory authorities. I think this company's securities are registered with the securities and exchange commission and therefore it filed form 10 K which bears our certification.

(Testimony of William H. Bell.)

Q. I was referring to the form U-6B-7, which they filed with the SEC in connection, presumably with an application under section 6, of the 1935 holding company act.

A. Which I think I doubt bore our certificate because I don't think it required it.

Q. Well, the exhibits attached to the company's declaration bore your certificate, you are aware of that, are you not?

A. No, I am not, but I am perfectly willing to take your word for it. [245]

Q. Very well, we will put it indirectly. You said at page 31, in response to the question as follows: "Would your answer be the same as to true components of cost such as interest during construction, which may not have been charged at all on the books of the accounting companies?

A. Yes, it would. As I see it there is no essential difference between interest during construction and taxes and insurance during construction. As to the latter, the charging of the items to construction involves a credit to an expense account." That is true?

A. That is right.

Q. Now what is a credit made to the expense account when taxes and insurance during construction are charged to construction?

A. Well, as to the mechanics of this thing, I suppose that it is possible that a payment or accrual of taxes could be split and part charged to construction and part charged to operating ex-

(Testimony of William H. Bell.)

penses, but I believe generally it is all charged to operating expenses, with a credit to the expense account and a charge to construction.

Q. Were you referring in that statement to current charges for taxes and insurance during construction rather than charges which had been previously made at some period in the past?

A. Well, I would resolve both of them, both of them, [246] that is constructively, if you are going to take out—if you are going to capitalize insurance, and capital applicable to construction—applicable to prior periods, constructively you relieve the expense account. I did not mean that they were actually going to do this on the books at all.

Q. That is entirely constructively, isn't it?

A. Naturally.

Q. And even might be as metaphysical as some of the matters you referred to in your direct testimony?

A. Well, you might possibly so characterize it, if you want to.

Q. Now, Mr. Priest put this question and you made this answer at page 31 and 32, did you not: "Mr. Bell, if the records of an accounting utility company are such that it is impossible to determine from them the original cost of plant items for the purposes of the new system of accounts would it be necessary to resort to estimates? A. No doubt it would." Do you recall that?

A. That is right.

(Testimony of William H. Bell.)

Q. Now that is no innovation in the Federal Power Commission's system of accounts as it exists as compared with previous systems of accounts in effect under which this company operated, is it?

A. Well, to the best of my knowledge it is. I am [247] perfectly open minded. If I am wrong I am willing to be shown that I am wrong.

Q. Well, if you will refer to the uniform system of accounts of the State of Oregon, effective January 1, 1925 you will find the following——

Mr. Laing: Mr. Slaff, just as a matter of convenience, would you mind putting that in the record?

Mr. Slaff: It is going to be offered. I can offer it, yes, I think you might just as well mark it at this time. [248]

Q. Now, with respect to the system of accounts of the Public Service Commission of Oregon effective January 1, 1925, Section 5 of the general instructions, a definition of the fixed capital account, provided as follows in part, did it not?

Mr. Laing: Mr. Examiner, may I interrupt? Have you offered Exhibit 19?

Mr. Slaff: I haven't offered it as yet. I can offer it.

Mr. Laing: I have no objection to its being received.

The Trial Examiner: Exhibit 19 will be received.

(Exhibit 19 was received in evidence.)

[Printer's Note: Exhibit No. 19 is set forth in Volume III.]

(Testimony of William H. Bell.)

By Mr. Slaff:

Q. That system of accounts now in evidence as Exhibit 19 provides in Section 5, general instructions and definitions of fixed capital accounts, reads: "Wherever the term 'original cost' is referred to in this classification and such cost cannot be ascertained, an estimate of the original cost shall be used." That is correct, is it not?

A. Yes, this refers, of course, to the determination book values of properties retired or otherwise disposed of.

Now, it may be that elsewhere in this classification of accounts, "Original cost" is referred to in that fashion. I do not know. Of course it says "Wherever the term 'original [249] cost' is referred to in this classification, and such cost cannot be ascertained, an estimate of the original cost shall be used." I don't know the significance of that other than with respect to retirement, as it is used here.

Q. In Section 5, the entire section which is headed "Application of Classification" refers, does it not, to expenditures for fixed capital as well as to retirements? A. Yes, you are right.

Q. And that instruction was identical with a similar instruction, Section 5, "General Instructions and Definitions" in the N. A. R. U. C. classification?

A. That is right.

Mr. Priest: Is that the 1913?

Mr. Slaff: No, this is 1925 classification.

(Testimony of William H. Bell.)

By Mr. Slaff:

Q. If the Company's idea of restatement of overheads prevails, doesn't that mean that the income statement of the company for the years 1937, 1938 and 1939 are understated to the extent that such overheads are applicable to construction?

A. Well, I suppose so in this same sense as those for the years 1925 to 1936; in that same sense.

Q. Did you, in your certification, did you call specific attention to the fact that the company's income [250] statements might be understated for the years 1937, 1938 and 1939?

A. No, we did not.

Q. You referred in your testimony to the systems of accounts of the Federal Communications Commission and of the Interstate Commerce Commission? A. I did.

Q. Do you know whether the I. C. C. or the Federal Communications Commission has ever permitted any such capitalization of overheads previously charged to operating expense, as you now propose? A. No, I do not know.

Q. Do you know of any utility which accounts for interest during construction, based on theoretical cash balances held as part of working capital?

Mr. Priest: That is not proper cross examination, Mr. Examiner. We did not go into that on direct.

Mr. Slaff: He is, Mr. Examiner, presented as an

(Testimony of William H. Bell.)

expert witness and he has testified very widely in the field of accounting and accounting practices.

The Trial Examiner: The Examiner, Mr. Priest, will not attempt to confine cross examination strictly to the scope of the direct, so long as the questions are within reasonable bounds; and of course that will be according to you, Mr. Priest, as well as to the Commission's counsel. [251]

I think the witness may answer.

By Mr. Slaff:

Q. Do you recall the question, Mr. Bell?

A. Will you—if you can phrase the question again?

Mr. Slaff: Will you repeat it, Mr. Stenographer?

(Question read.)

A. I do not.

By Mr. Slaff:

Q. And do your know of any utility which accounts for interest during construction based upon theoretical material and supplies held as part of working capital?

A. "Theoretical material and supplies held as part of working capital". I would say that I know of no utility which has capitalized interest—the question was interest during construction—on any materials other than those expressly purchased for construction.

Q. And would your answer be the same with respect to the charging of taxes during construction? A. Yes.

(Testimony of William H. Bell.)

Q. In connection with such matters?

A. Yes, construction and interest and taxes are all in the same pot as far as I am concerned.

Q. When you speak of material purchased directly for construction, can you elaborate or be more specific as to exactly what you mean? [252]

A. I hardly know how to be more explicit than that. It is a well-recognized principle that it is proper to charge interest and taxes and insurance applicable to construction of property while the construction is in process, and until it is completed. I suppose it might be possible for materials to be purchased expressly for construction and be held a considerable time in connection with a definite construction program. Naturally, there would be a limit to the time during which it would be proper to capitalize any overhead charges with respect to that sort of stuff.

Q. But with respect to materials normally held in stores, which may go into construction, you don't think it in accord with sound accounting principles to charge interest during construction, and taxes during construction, normally, until the materials leave stores and go into specific jobs?

A. I take it you mean material which might be used for construction and might be used for replacement?

Q. Yes.

A. No, I could hardly justify the inclusion of interest, taxes and insurance on that stuff. [253]

C. W. PLATT,

recalled as a witness on behalf of the Respondent, having been previously duly sworn, testified as follows:

Further Direct Examination

By Mr. Laing: [258]

Q. Mr. Platt, will you turn to pages 17 and 18 of the Joint Report? A. Yes, sir.

Q. That section of the report deals with what subject matter, Mr. Platt? What is the caption of that part of the report?

A. The caption reads: "Unsupported charges to electric plant, common stock ($3,500,000)".

Q. What page is that, Mr. Platt?

A. It is on page 17 with further comments on the same subject extending over to another page, 18.

Q. The Examiners in discussing that item, after according the company—quoting from the company's report on the subject, make what comment as to the text of account 301, particularly in reference to that $3,500,000?

A. It quotes the——

Q. What comment does the report make before it approaches the account?

A. It says, "The text of Account 301, Organization, does not provide for the inclusion of any such item as described above. Furthermore, electric plant Instruction 3-D provides as follows:——

Q. Before you quote that or read that, Mr. Platt, I wish you would pick up Exhibit No. 6, the Uni-

(Testimony of C. W. Platt.)

form System, and read into the record [illegible] of Account 301. [259]

A. Account 301 is defined in the Exhibit 6 as follows: "Organization. This account shall include all fees paid to Federal or State governments for the privilege of incorporation and expenditures incident to organizing the corporation, partnership, or other enterprise, and putting it into readiness to do business."

Q. Then, that is followed in the description of the accounts in Exhibit 6 by a list of items and a couple of notes, is it, on page 56 of the Uniform System of Accounts?

A. The items that are listed here are as follows:

1. Cost of obtaining certificates authorizing an enterprise to engage in the public utility business.

2. Fees and expenses for incorporation.

3. Fees and expenses for mergers or consolidations.

4. Office expenses incident to organizing the utility.

5. Stock and minute books and corporate seal.

Q. Now, if you will turn to page 9 of the uniform system of accounts, Exhibit 6.

A. What page did you say?

Q. Page 9 of Exhibit 6. What does the uniform system there have to say as to the interpretation to be given to the list of items?

A. This is General Instruction 5, which reads as follows: "Lists of items appearing in the texts of

(Testimony of C. W. Platt.)

the accounts or elsewhere herein are for the purpose of more [260] clearly indicating the application of the prescribed accounts——"

Q. (Interrupting) Prescribed "accounting"?

A. You are correct—"Prescribed accounting. The lists are intended to be representative, but not exhaustive. The appearance of an item in a list warrants the inclusion of the item in the account mentioned only when the text of the account also indicates inclusion, inasmuch as the same item frequently appears in more than one list. The proper entry in each instance must be determined by the texts of the accounts."

Q. In other words, whether an entry should be made in Account 301, Organization, or not, depends on whether it comes within the class of costs that is defined by the account itself? Is that the idea?

A. That is right.

Q. And the definition of the account, among other things, is that it includes expenditures incident to organizing the corporation or entering it and putting it in readiness to do business; that is what it says, is it not? [261]

A. That is right.

Q. Now following the statement of page 18 of the joint report, that Account 301 does not provide for the inclusion of any such item as described above, the joint report goes on to state what, Mr. Platt?

(Testimony of C. W. Platt.)

A. "Furthermore, electric plant instruction 3-D provides as follows: 'When the consideration given for property is other than cash, the value of such consideration shall be determined upon a cash basis. If the entry recording such transaction, the actual consideration shall be described with particularity to identify it. The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration if other than cash.'"

Q. After quoting that instruction 3-D, how does this section of the Examiner's Report conclude?

A. It concludes as follows: "In the instant case, the company has not determined the value of such consideration on a cash basis, and has not furnished the Commission the particulars of its determination of such cash value. Therefore the examiners have transferred the amount of $3,500,000 to Account 107, Electric Plant Adjustment."

Q. Now taking up this concluding observation of the examiners first, and waiving for the moment the question of whether the item is properly classified in 301, I wish you [262] would make your own comment as to this conclusion of the examiners: "It will be noted that part of the examiners' criticism of this item is directed to the alleged failure of the Company (1) to determine the value of such consideration (the 100,000 shares of common stock) on a cash basis, and (2) to furnish the Com-

(Testimony of C. W. Platt.)

mission with the particulars of its determination of such cash value. In view of the company's placing the figure of $3,500,000 on this consideration in its reclassification study as filed with the Commission, it is apparent that the only point to this part of the examiner's criticism is the Company's alleged failure to furnish the Commission 'with the particulars' of the company's determination.

While there is nothing in the record of the correspondence with the Commission, prior to the service upon the Company of the Joint Report of the examiners, to show that any request was made upon the Company to supply such particulars, or that the Company was not 'prepared to furnish' the particulars when asked for, as provided by Instruction 3-D, the Company by letter to the Commission dated May 31, 1940, in response to letter dated May 1, 1940, from Chas W. Smith, Chief of the Commission's Bureau of Accounts, Finance and Rates, did set forth certain facts and circumstances pertinent to such determination, and is prepared to supply additional particulars on this subject." [263].

You refer to the Company's letter to the Commission, dated May 31, 1940. That is the letter which has been admitted and entered in this proceeding as Exhibit No. 5, is it not?

A. It has been admitted. I do not recall the number.

Mr. Laing: Is that the correct number of that Exhibit, Mr. Examiner?

(Testimony of C. W. Platt.)

The Trial Examiner: I believe that that is correct, yes, the letter of May 31, 1940.

Q. Mr. Platt, I wish you would take up the whole subject of the 100,000 shares of stock, and give us some information about the circumstances surrounding their issue, and how the stock was used by the people to whom it was issued.

A. "As indicated in the Company's Reclassification report to the Commission, and in its said letter of May 31, 1940, these 100,000 shares were issued to the promoters of the enterprise for their services in organizing the 'enterprise and putting it in readiness to do business.'" You will notice that the last eight or ten words are a direct quotation from the definition of Account 301, Organization.

The enterprise did not reach its effective date of plant operation until July 1, 1914, (see page 14 of Joint Report) and until that date it was being "put into readiness to do business" by the promoters and organizers to whom [264] these 100,000 shares of common stock were issued as compensation. During that period of approximately three and one-half years, the 100,000 shares of common stock represented the entire capital stock of the enterprise, issued or authorized, and the record shows that the stockholders, in addition to their other contributions, employed this stock in furtherance of the financing of the enterprise and of "putting it into readiness to do business".

(Testimony of C. W. Platt.)

For example, in 1913, 90,000 of these 100,000 shares were pledged by the stockholders as security for a Gold Note issue, dated as of August 15, 1913, and made under an indenture under which Guaranty Trust Company of New York and Continental Trust and Savings Bank of Chicago were trustees; and in 1914 and 1915, approximately 45,000 of these 100,000 shares were in effect turned over as treasury stock to enable the Company to float the sale of its 6% preferred stock authorized in April of 1914, and to induce subscribers on partly paid subscriptions to a proposed bond issue to purchase 6% preferred stock in satisfaction of their part payments for the bonds which were not issued. And, as quoted on page 18 of the examiners' report from the Company's statement, "The principal incorporators served in executive and administrative capacities from the date of incorporation to March, 1925, having served without compensation until after the company had passed through the [265] initial development period and was ready for permanent financing. They gave personal attention and direction to the acquisition of lands and water rights for the hydro electric plant, to the purchasing of supplies and equipment, to administrative and general supervision of construction, to the securing of franchises and connected business, and to other corporate matters. They negotiated the short term obligations referred to above, guaranteeing them in

(Testimony of C. W. Platt.)

large part by their own endorsements and in due course sold by solicitation at their own cost and expense a large issue of preferred stock of the company.

"As compensation for their promotional efforts and their executive and administrative services to the company extending over a period of years as outlined above, for the risk incurred in furnishing capital and guaranteeing large sums of money invested in an unproven enterprise, and for costs incurred in the solicitation and sale of the preferred stock issue, the incorporators received as their entire compensation the common stock of the company which was issued to them in an amount of 100,000 shares."

Q. (By Mr. Klug) Did I understand you to say that that was a quotation from the Examiner's Report?

A. Quoting the company's statement.

Mr. Klug: Yes, that is correct.

Q. (By Mr. Laing) Now, Mr. Platt, the purpose of [266] this general inquiry that we are going through is to determine the original cost of the property of the company, is it not? A. It is.

Q. And what property did the company obtain for the issuance of this 100,000 shares of stock?

A. The "property" received by the Company for these 100,000 shares of stock consists of the efforts, services and accomplishments of the organizers of the enterprise by way of "putting it into

(Testimony of C. W. Platt.)

readiness to do business" and establishing it as a going concern. This property, as demonstrated by the history and present status of the Company, was and is of substantial value.

Q. Now what consideration did the company give for that property?

A. It was bought and paid for with the 100,000 shares of common stock, and, under the terms and provisions of the Commission's "Uniform System of Accounts", the Company and the Commission are now confronted, more than 25 years after the property was obtained, with the problem of determining on a cash basis the value of the consideration given for this property; namely, the value of the 100,000 shares of stock. In the meantime, the Company has passed into entirely different management, American Light & Power Company having bought these 100,000 shares of stock in [267] 1925 from the then 490 owners thereof.

As to what the cash value of this stock may have been at or about the time of its issuance, and the determination by the then managing directors of the corporation that the stock was fully paid, an exact determination at this time, more than 25 years later, is obviously a difficult problem.

Q. Now, Mr. Platt, such resolutions as appear in the records of the Northwestern Electric Company with reference to this stock, the method of declaring stock to be paid——

Mr. Slaff: I did not get that last.

(Testimony of C. W. Platt.)

Q. (Mr. Laing) The manner of declaring the stock to be paid up, were they made before or after the American Power & Light Company acquired the stock?

A. The present management of the Company is no wise responsible for the form or substance of the resolutions adopted by the former directors in 1912 and 1915, declaring the two 50,000 share blocks of the common stock to be paid up. These resolutions are ambiguous, if not actually misleading, in their references to the physical properties mentioned or referred to therein, and the present management of the Company has never predicted any claim thereon.

Mr. Slaff: I move to strike, Mr. Examiner, the last statement beginning "the resolutions are misleading," and so forth. [268]

The Trial Examiner: Oh, I don't believe that there would be any benefit in striking the testimony, Mr. Slaff.

Mr. Laing: You don't doubt the statement, do you, Mr. Slaff?

Mr. Slaff: Well, I don't think it is proper for this witness to tell us about it, as he did with reference to that conclusion that he stated.

Mr. Laing: I don't assume that his testimony will be given any greater weight than it is entitled to.

The Trial Examiner: That will be the attitude of the Examiner.

(Testimony of C. W. Platt.)

Mr. Laing: I doubt if anyone in this room who has read the resolutions would have a different opinion.

Mr. Laing: Q. Mr. Platt, has the management of the Northwestern company had any occasion to take up any aspect of this common stock at any time in the last eight or nine years, with the regulatory authorities?

A. In 1933 and 1934, the officers of the Company under its present management were called upon by regulatory proceedings then pending in Oregon and Washington, respectively, to appraise the historical cash cost to the company on the prudent investment theory, of the services received by it from the organizers in exchange for the 100,000 shares of stock. This problem was distinctly not one of determining the value of the stock issued to the [269] organizers for their services, or of appraising all the intangible values created or contributed by these organizers, but one of determining, in the absence of a cash transaction at the time what the cash cost of such services might be if then paid for in cash by the Company. This amount was estimated by the Company, on the basis of such information as was available at the time, in response to the problem as so stated, at $400,000, exclusive of general intangible values, and testimony to that effect was given before the regulatory authorities of these states at hearings held in Portland, Oregon, in June of 1933, and at Olympia, Washington, in March of 1934. This

(Testimony of C. W. Platt.)

$400,000 was then placed on the Company's books of account, under the classification then in force, under the Organization Account, and the remaining $9,600,000 was classified temporarily as non-operating intangible.

Q. Perhaps it will be in order to make clear there, Mr. Platt, what you mean by the $9,600,000.

A. That would be the remainder out of the total of $10,000,000. It is the result of multiplying 100,000 shares of stock by $100 of par value.

Q. You may proceed.

A. This action did not reflect the opinion of the management of the company as to all the values obtained by the Company in exchange for the common stock, or the judgment of the management as to the proper final classification [270] final classification or disposition of the $9,600,000 then classified as non-operating intangibles.

In October of 1936, after the company had reduced the par value of its common stock to $3,500,000 and reduced the non-operating intangible item to $3,100,000, a conference was held at Portland by the heads and staff representatives of the two state regulatory bodies at which representatives of the Company were also present. At that conference, the two commissions sought to reach an agreement on the treatment of certain items of the Company's property employed jointly in the two states, including the $400,000 of organization expense claimed by the Company on the prudent investment

(Testimony of C. W. Platt.)

historical cost basis at the 1933 and 1934 hearings. At this conference, the responsible heads of these two regulatory bodies, as part of a general agreement on various items, announced that $100,000——

Mr. Kurtz: Just a minute. May I inquire who are these "responsible heads" that he is talking about?

Mr. Laing: Well, I will ask him.

Mr. Kurtz: There is no showing here that the Commissioner of Public Utilities was there, and it is incompetent, irrelevant and immaterial.

The Trial Examiner: The objection will be overruled.

Q. Go ahead. We will find out who they are.

A. ——announced that $100,000 of this $400,000 of [271] Organization expense would be recognized in determining historical cost of the prudent investment in operating property.

Q. Mr. Platt, let me interrupt you there. Do you recall that the representatives of the Oregon Commissioner were present?

A. They were, Mr. McCulloch, the Commissioner, and Mr. Van Scoyoc, a member of his staff.

Q. Do you recall who was present as the head of the Department of Public Service?

A. Mr. Ferd Schaff.

Q. What was his position?

A. He was the Director of the Department of Public Service of the State of Washington.

(Testimony of C. W. Platt.)

Q. I understand you to say that these two men were the heads of their respective regulatory bodies and by a general agreement between them announced that $100,000 of this organization expense would be recognized in Account 301 as the Historical Cost of the prudent investment of the operating company; is that right?

A. That is right.

Q. What happened after that?

A. In deference to this agreement between the representatives of the two commissions on the so-called prudent investment historical cost figures, and with no other purpose in mind, the Company recorded on its books as of December 31, [272] 1936, a reduction of the $400,000 of Organization expense to $100,000, transferring the remaining $300,000 to the non-operating intangible account, and increasing that item to $3,400,000. However, no order relating to the prudent investment historical cost of the Company's property has since been entered by either the Oregon or the Washington regulatory authority.

As I have already indicated, these discussions in 1933, 1934 and 1936 of certain phases of the organizers' services did not represent attempts to determine the value of the consideration given by the Company, namely the 100,000 shares of stock, for the values contributed by the organizers in putting the enterprise into readiness to do business as a successful going concern.

(Testimony of C. W. Platt.)

Q. Now, Mr. Platt, what have you found that does bear on the value of these 100,000 shares of stock that represents the consideration which the company gave for these services?

A. I believe that there is substantial evidence of the value of these 100,000 shares of stock available from transactions occurring within a reasonable period of time after the company's effective date of operation. The American Power & Light Company paid something over $5,000,000, or $50.00 per share for these 100,000 shares of stock in 1925.

Mr. Slaff: If the Examiner please, I move to strike [273] this last statement of the witness as irrelevant to the termination of the consideration of the value of the consideration received by the company for the issue of its stock to the promoters. What stock some subsequent promoters or entrepreneurs bought 12 years ago or thereabouts, for control of this company, has nothing to do whatever with what we are attempting to determine here in this proceeding.

I therefore more to strike that last statement of the witness.

Mr. Laing: Mr. Examiner, I think that counsel for the Commission is laboring under a considerable misapprehension throughout the discussion today on this one point. The Instruction 3-D specifically provides that when the consideration given for property is other than cash—now, the only person who gives consideration for property is obvi-

(Testimony of C. W. Platt.)

ously the company. This account Instruction reads, "When the company gives a consideration for the property other than cash, the value of such consideration shall be determined on a cash basis." Now, we have this problem here, which, for all practical purposes, may be the same thing as if the company had spent two million or three million or three and a half million dollars for some services or property which from some standpoint might be subject to criticism as to whether it was a reasonable or prudent expense. But from the standpoint of determining, as this classification undertakes to determine, [274] what the cost incurred by the company was, this account and this instruction make it perfectly plain that it is the duty of this Commission and the duty of the Company to indicate what the value of the consideration given by the company was, and under the circumstances we are compelled to ascertain what the value of this 100,000 shares of stock was as of the time as is reasonably related to the period during which those shares remain available.

The Trial Examiner: Do I understand that the witness referred to an actual purchase of this stock by the American Power & Light Company?

Mr. Laing: Yes sir, for——

The Trial Examiner: And that was the figure that the witness stated?

Mr. Laing: That is right.

(Testimony of C. W. Platt.)

The Trial Examiner: Is there something further, Mr. Slaff?

Mr. Slaff: Yes. I would like to say, with all due deference, that I have not been laboring under the slightest misapprehension, and counsel's quotation of Instruction 3-D bears out exactly the correctness of the apprehension which I have with respect. And I might say further that I apprehend that we will get into far fetched realms having nothing to do with our problem, if the witness is allowed to testify as to such matters. It is quite obvious, from that instruction, [275] that what is to be determined is the value of the *considera-* to the company. This uniform system of accounting is not prescribed as a system of accounting for Mr. Herbert Fleishhacker or any other entrepreneur. It is a system of accounts of the Northwestern Electric Company or any other company subject to the jurisdiction of the system. And when it speaks of the value of such consideration, it can only speak of that in no other respect but the value to the company. Now the value of the consideration received to the company in 1912 or thereabouts can't be determined in the slightest by the price which a promoter pays 12 or 13 years later for stock held by an original promoter. It is so completely irrelevant and far fetched that it cannot have the slightest bearing on what this commission is trying to determine here.

The Trial Examiner: Mr. Slaff, the Examiner would prefer to give that some thought. In any

(Testimony of C. W. Platt.)

event it will not be harmful. I think the Examiner will deny the motion to strike, and allow the answer to stand. [276]

Mr. Laing: I think part of counsel's problem is the apparent desire on his part to rewrite this Instruction 3-D. Certainly there is a vast difference in language and significance between the word "consideration" and of the word "received" when we are reading this instruction, "When a consideration given for property is other than cash." That does not show when a consideration was received by the Company, was paid for by something else than cash. It says when a consideration given for property is other than cash, and that is what we are undertaking to find the value of.

The Trial Examiner: We will let the answer stand, Mr. Laing.

By Mr. Laing:

Q. Now, Mr. Platt, how did this common stock come to have a par value on the Company's books of three and a half million dollars?

A. Eleven years later, with the cooperation and consent of the American Power & Light Company——

Q. That is, by later, you mean later than 1925?

A. Later than 1925. And with the unanimous approval of the stockholders, preferred and common, at a meeting held in September of 1936, after the trustees or directors on the basis of current engineering appraisals had found that the value at-

(Testimony of C. W. Platt.)

tributable to the common stock, without consideration of the surplus account, was not less than $3,500,000, the [277] Northwestern Electric Company reduced the par value of the common stock to $35 per share, or to an aggregate par value of $3,500,000.

Mr. Slaff: I move to strike from the witness' last answer the statement with respect to the appraisal, the value found by an appraisal at approximately 1936 of $3,500,000. It is utterly irrelevant, and eleven years more removed from the date at which we are attempting to find the value of the company.

Mr. Laing: Mr. Slaff, my main purpose in offering the testimony with respect to that transaction was to show when determination was made by the directors of the Company and what it amounted to was, of course, to provide a proper historical explanation of the present par value of this stock, and how it came to amount to that particular sum.

The Trial Examiner: The only thing, Mr. Laing, the statement is based on an appraisal that was said to have been made, and counsel for the Commission would be deprived, of course, of any opportunity to explore this appraisal in the event he so desires. That would seem to me to be the hostile part of that testimony.

Mr. Laing: If the Examiner please, our main interest in this statement is the historical relation to the whole matter. I appreciate that we were un-

(Testimony of C. W. Platt.)

dertaking, for the purpose of these proceedings, to determine the value of this [278] stock on the basis of the appraisal that was acted upon by the directors and trustees would be in order to present witnesses to the appraisal. I have thought that it is important in this regard that the status of that stock should be brought out, and how it came to be determined in the account to be $3,500,000, and that it did represent action by the stockholders and directors of the company at a certain time.

And we shall be very glad to submit into this record copies of the resolutions and minutes, merely to make that historical record more complete.

Mr. Slaff: If Mr. Laing is willing to stipulate that the 1936 appraisal referred to by Mr. Platt has nothing to do with the determination of the value at the time the stock was issued, then I have no objection to a statement by Mr. Platt, as merely a statement in historical sequence.

Mr. Laing: I recognize that this determination in 1936 is only a secondary relation to the problem that we have to deal with. I think it is important that the Commission and all concerned should know exactly how this determination was made, and that it does represent and did represent the determination made by the directors at that time, whatever that interest may be to the Commission in connection with its investigation of this property.

The Trial Examiner: Well, the Examiner, Mr. Laing, is [279] interested in the background, and

(Testimony of C. W. Platt.)

the Commission perhaps would be. But the question that comes to my mind, in testimony of that nature, is the unfairness of such testimony without counsel having an opportunity to explore a statement of that nature.

Mr. Laing: Well, the Company is confronted here with the problem in part of justifying its accounts. It is presenting here in this particular respect the record of what the trustees and officers did in 1926 with this particular problem. If further elaboration of that action by the trustees and stockholders is desired, we shall be glad to submit it. But we think it not only is necessary to an understanding of the whole problem, but that it at least has some indication of the corporate judgment of the management of the corporation as to what at least at that time was the value of the common stock.

Now, whether that is too remote to the period around 1912 to 1916, is perhaps altogether another question. And I am perfectly willing to concede that there may be a considerable difference of opinion on that subject.

The Trial Examiner: Is it possible, Mr. Laing, for the witness to continue along that line without reference to this so-called appraisal that he speaks of?

Mr. Laing: Well, I merely refer to the appraisal as a part of the inducement or action which the trustees decided [280] the matter. I don't care to

(Testimony of C. W. Platt.)

ask Mr. Platt any more questions about this particular transaction in 1936. I think it has at least some—throws some light on the matter. It is important as a matter of history, and whether it is too remote from the time the stock was issued and the consideration given is, of course, a matter of judgment.

We are dealing with a problem that is rather difficult in this late day, some twenty-five years after, to try to find out what the value of those 190,000 shares of stock was. If the Commission feels, after a full consideration of the record, that this action or judgment of the Board in 1936 is not entitled to any weight, then that will be its judgment. But I think that the Commission is entitled to the opinion.

The Trial Examiner: I believe there is a motion pending before the Examiner. Can you find it, Mr. Reporter?

(Motion read.)

The Trial Examiner: The Examiner is inclined to grant the motion to strike the testimony relating to this appraisal. The motion will be granted.

By Mr. Laing:

Q. Mr. Platt, have you any information as to the market prices realized from the sales of this common stock in the early period shortly after the stock became available to purchasers? [281]

Mr. Slaff: I object to that, Mr. Examiner. The market price of the stock may have been dependent

(Testimony of C. W. Platt.)

upon the earnings of the Company, and it may have been dependent upon any number of phases, which is obviously improper to any consideration to be made here by the Commission.

The Trial Examiner: I think, Mr. Slaff, that that question comes within the same category as the purchasing of the stock by the American Power & Light Company. The objection will be overruled.

Mr. Slaff: I agree entirely with that statement.

The Trial Examiner: I believe the Examiner explained at the time the matters that prompted his rulings.

By Mr. Laing:

Q. Mr. Platt, when was this stock first available for trading on——

The Trial Examiner: Did Mr. Plattt answer your question that was objected to?

Mr. Laing: I don't know. I asked him if he had information, and I think he nodded his head. I don't know whether that became audible or not.

(Question read.)

A. Yes, I have. [282]

Q. When did that stock first get into hands that made it available for purchase and sale on the open market?

A. The stock was not actively traded in until 1916, when approximately 45% of the stock had passed into the hands of 6% preferred stockholders.

Q. Have you any information as to sales prices.

(Testimony of C. W. Platt.)

market prices on sales of that stock on any regular stock market during the year 1916?

A. Yes, it is listed on the San Francisco Stock Exchange—Stock & Bond Exchange, for the year 1916. I have those figures here. They are contained in Walker's Manual, California Securities, 1917 Edition.

Q. Is that Manual regarded and regularly accepted as an authentic record of market sales and transactions in that territory? A. It is.

Q. And is it still so regarded? A. It is.

Q. What quotations does that Manual give, showing actual sales during the year 1916 of Northwestern Electric Company's common stock?

A. The quotations by months are as follows, for each month, the first figure is the low and the second figure is the high:

January	15½	22 [283]
February	21	25½
March	22	22 5/8
April	20	22 3/8
May	20 3/4	21
June	21 1/2	23 3/4
July	Nothing for the month of July	
August	20 1/4	23
September	22 5/8	24
October	No low shown	22

Mr. Slaff: How do you determine that is high instead of low for that month?

(Testimony of C. W. Platt.)

A. I am reading from the way it is here, tabulated in this report.

November	20	20 1/2
December	20	20 1/2

Q. Mr. Platt, you have heard testimony that was offered with respect to Mr. Renz this morning—at least you heard the offer of the testimony?

A. I did.

Q. I will ask you this question, whether the information which was offered to be proved through the witness Renz and the documents had come to you in substantially that same form long prior to the date of this hearing? I mean, did the officers of the company, including yourself, have similar information as to this cash settlement of $22.50 a share? [284]

A. The officers of the company, including myself, had no knowledge of that until some time in 1936, at or about the time that the par value of the common stock was changed.

Q. You did not have the information at that time?

A. Yes, I did not have it. I might add in 1933 and 1934 during the time when investigations were being carried on by the Oregon and Washington regulatory authorities——

The Trial Examiner: May I inquire how much longer your direct on this subject will take?

Mr. Laing: I am just about finished.

(Testimony of C. W. Platt.)

The Trial Examiner: You are. Very well.

By Mr. Laing:

Q. Referring to this classification of reports, this figure of $3,500,000, in Account 301, Organization, the value of the consideration received by the Company for these services, I take it that you must have considered all of those factors, Mr. Platt, when you were undertaking to express your best judgment on that subject?

A. I have; and on the basis of all this evidence, including the demonstrated success of the enterprise prior and subsequent to the purchase by the American Company in 1925, it is my judgment that the $3,500,000 determination of value shown in the Northwestern Company's reclassification report to the Commission is a fair determination of such value [285] as of the time when the former directors of the Company declared the entire 100,000 shares of stock to be paid up.

Q. And that—why was it put in Account 301, Mr. Platt?

A. In the report filed by the Company pursuant to such proposed reclassification, the entire $3,500,000 has been included in Account 301, Organization, as cost of intangible capital, in which account I believe this sum must be recorded if the Company's books are to be retroactively rewritten to conform with the definitions and requirements of the uniform system.

Q. I take it you recorded it in that account on

(Testimony of C. W. Platt.)

the theory that it represents an expenditure in organizing the enterprise and putting it in a position to do business?

A. That is right. It represents a judgment figure.

Mr. Laing: That is all.

The Trial Examiner: Step down, Mr. Platt. We will take a recess until 10 o'clock tomorrow morning.

(Whereupon, at 5:05 o'clock p. m., the hearing was adjourned until 10:00 a. m., Wednesday, July 24, 1940.) [286]

L. T. MERWIN,

a witness produced on behalf of Respondent, being recalled, further testified as follows: [349]

Cross Examination

By Mr. Slaff:

Q. And your company will still continue to perform that same public service whether the Federal Power Commission follows the recommendations of your accounting officials or follows the recommendations of its staff, won't it?

A. It will endeavor so to do, sir.

Q. And you haven't any doubt that it is going to succeed?

A. Not unless I am confined to this room twenty-four hours a day.

(Testimony of L. T. Merwin.)

Q. You testified, Mr. Merwin, with respect to Exhibit 15, at page 135 of your testimony, that this statement demonstrates the fact that a great deal of original study, development work and consequent incurring of general expense on the part of the general staff was necessary, and that the general expense represents a fair and legitimate part of the total capital investment. You so testified, didn't you? A. I did.

Q. Is it a proper inference to draw from your testimony that you believe, too, that expenses of this nature which have been previously charged to operating expenses prior to January 1, 1937, and also subsequent thereto, up to the present time, should now be charged to electric plant? [350]

A. It is my opinion that some of the charges that are entered heretofore to operating expense can, and rightly should be allocated to construction operation, if there is an endeavor to ascertain what I believe this hearing is for, the original cost.

Q. Are you making distinction between original cost of the utility's property and cost of the utility property as property? A. No.

Q. Then your statement is that your opinion is, and you have just stated it to be that, if an attempt is being made to show on the books of the company the cost of the company's property, that is correct?

A. Yes.

Q. Now you have always attempted, and been

(Testimony of L. T. Merwin.)

required, as a matter of fact, have you not, to show upon your books the cost of your property?

A. That is a matter of accounting in which I am not particularly concerned, myself, under the belief that our present practice is that which has been followed for some 14 or 15 years, and I have made no investigation of it, or endeavored to change it. I have left that to the judgment of the accounting officials.

Q. Well, you are the chief executive officer of the company, and have been for a considerable number of years; [351] that is correct?

A. No; only for four years.

Q. And you have been connected with the company for how long? A. 28 years.

Q. And prior to becoming president of the company, immediately prior thereto, what was your position?

A. Vice-president and general manager.

Q. And how long had you occupied the position of vice-president and general manager?

A. From 1920 to 1936.

Q. So from 1920 to 1936 you were second in command of the company? A. That is right.

Q. And it is a fair statement, is it not, Mr. Merwin, that your books have been intended to show the cost of your company's property during that entire period?

A. I have accepted the books as compiled and presented by our secretary-treasurer, who is in charge of the general accounting.

(Testimony of L. T. Merwin.)

Q. Well, as first in command or second in command of the executive staff, you have attempted, have you not, to see to it that your books did reflect the cost of your company's property?

A. No, no, I left that entirely to the judgment of [352] the accounting office.

Q. Then are you now merely accepting the judgment of the accounting officers as to what should be done, without coming to any independent conclusion of your own? A. I probably shall.

Q. Well, then am I correct in assuming that the opinion which you expressed earlier, in response to the third or second question which I put to you, was merely your acceptance of the accounting officers, rather than your own independent judgment?

A. No, not entirely so.

Q. Well, as one of the chief executive officers, and as the present chief executive officer, did you feel any responsibility on yourself to see that the accounts of the company were kept by the proper accounting officials so as to show the cost of the company's property?

A. I simply relied upon the chief accounting officer and counsel, and the results were presented to our Board of Directors, and were apparently satisfactory to them.

Q. That is to say, the results which were presented to your Board of Directors represented the judgment and opinion of the Accounting Officers as

(Testimony of L. T. Merwin.)

to the cost of your company's plant, and also the income of your company, year by year?

A. Yes, sir. [353]

Q. And you accepted that, year by year, and acquiesced in it? A. I did. [354]

C. W. PLATT,

Recalled as a witness on behalf of the Respondent, having been previously duly sworn, testified as follows:

Recross Examination

Mr. Slaff:

Q. I think you testified in your direct examination, Mr. Platt, that you had been treasurer of Northwestern [361] Electric Company Since 1925?

A. That is right.

Q. And prior to that time were you accounting officer of any other utility company?

A. I was secretary and treasurer of Pacific Power and Light Company from April, 1924, until I believe the spring of 1935 or 1936, I forget which.

And as I have already related, I was assistant secretary and assistant treasurer of Portland Gas and Coke Company from 1912 to 1924, and secretary-treasurer of that company from 1924 to date.

Q. And did you hold a similar office with the Inland Company?

(Testimony of C. W. Platt.)

A. Yes, I was an officer of the Inland Company for a few years, I don't recall just what the dates were.

Q. You were the accounting officer, the chief accounting officer? A. That is right.

Q. During all the time that you have been connected with the Northwestern Electric Company it has been subject to systems of accounts prescribed by the Oregon Commission and the Washington Commission? A. That is right.

Q. And you have, of course, attempted to comply with those systems of accounts and to keep the books of the company [362] as directed by those systems?

A. Yes, and as we were able to interpret them.

Q. Sure. And there is, I suppose, a fundamental basis of accounting pursued by all utilities, in conformity with state classifications?

A. I will have to say fairly uniform. There obviously must be some variations in practice resulting from two things.

Q. Go right ahead.

A. Resulting from two things, one a difference in the interpretation, and the other is the particular type of corporate organization.

Q. Yes, I didn't—perhaps you misunderstood me——I didn't use the term "uniformly" in my question. I said there was a fundamental basis of accounting which is pursued by all utilities in conformity with state classifications?

A. That is right.

(Testimony of C. W. Platt.)

Q. And beyond that there is a wide diversity of methods that may be employed?

A. That is right.

Q. And there is then, another way of stating it is that there is a margin or an area of discretion as to accounting methods, accounting entrys within the fundamental principles of accounting that you attempt to follow?

A. There is some field for discretion, I don't know just how far you could say that they get—how far you could [363] say that they go within the field of fundamentals.

I am afraid we are talking about something that is a little bit indefinite in character. I try to answer your questions as well as I can.

Q. Well, you understand that, as you testified just a moment ago that there is a fundamental basis of accounting pursued by companies which are regulated in conformity with the requirements of the regulatory authorities as expressed in accounting classifications. A. That is right.

Q. And beyond that, as I think you stated also, there is a wide diversity of method of putting into practice those fundamental bases of accounting that you might pursue?

A. I think my answer should be in the affirmative. I don't know just exactly what is meant by the term "wide". I think there are some reasonable restrictions upon it.

Q. Let me explain, Mr. Platt, that the only

(Testimony of C. W. Platt.)

reason I used that term was because it was exactly the term that you used before the Oregon commission at one time. A. All right.

Q. That is exactly the status which you——

A. (Interrupting) I simply mentioned it for whatever meaning it may have had.

Q. And I presume it had substantial meaning, as your testimony then had and now has. [364]

A. It must have had, surely.

Q. Now, what are the functional fixed capital accounts of a utility?

A. They are the prescribed accounts by which—in which the course of fixed capital is subdivided by functional performance and duties.

Q. And the transfer of items from one functional fixed capital account to another, and that alone doesn't require any recomputation of such items, does it? A. Not that alone.

Q. Well, suppose we left out that phrase, "that alone" and I ask you whether a transfer of items from one account, one functional fixed capital account to another involved any recomputation?

A. Not per se unless the accountant approaching such a situation were to find that there was some error in the account which he proposed to transfer.

Q. When did you start making your studies pursuant to instruction 2D of the Electric Plant account instructions of the Federal Power Commission system of accounts, exhibit 6 in this case?

(Testimony of C. W. Platt.)

A. As I recall it, we started our undertaking some time in the latter part of the year 1937. The system became effective on January 1, 1937; and instructions 2D provided that not later than two years after the effective date of this [365] system each utility shall have completed the studies necessary for classifying its electric plant, and so on.

Q. And so you began your studies toward the end of 1937, is that right? A. That is right.

Q. Now with whom did you consult at the outset in determining the scope of the studies and what was to be considered within them? What the policy with respect to them was to become?

A. My first approach would be examining the classification to see what the job appeared to be; to see what differences there were in classification of functional accounts, and made out a chart or drafted a memorandum which set forth what in my judgment would need to be done and then I called in the several accountants on the staff who would become involved.

Q. That is your staff?

A. My staff. Who would become involved in these reclassifications, of which, incidentally, there were quite a few between functional accounts. From there it became necessary to call in some engineering assistance in order to make sure that we knew what the proper definitions of these functional accounts were and in some instances it became necessary further to ask these engineers to make some

(Testimony of C. W. Platt.)

estimates for us because the records did not reveal exactly what the cost of [366] some particular items was, that it was necessary to transfer from one account to another.

Q. Were these engineers within your own organization?

A. They were. And I would like to add here——

Q. Go right ahead.

A. I would like to add here that the further we got into it the more we found that actually needed to have extensive study made in order to find out what these costs were that had to be transferred from one fixed capital account to another.

Q. And you proceeded to make such extensive studies, is that correct? A. We did.

Q. Did you consult with—what is the name of the service company? A. Ebasco Service.

Q. We can refer to that as Ebasco?

A. That will be satisfactory, I think, for the record.

Q. Did you consult with any of the officers or employees of Ebasco?

A. We are constantly in consultation with that service organization, because we have a contract with them.

Q. I think, if you will, I think you might state for the record, Mr. Platt, because I don't think it appears in the record so far, just what Ebasco is in a general way, [367] very general, if you can, the relation between your company and Ebasco.

(Testimony of C. W. Platt.)

A. Ebasco Service, Inc., is an organization having its headquarters and office at 2 Rector Street, New York City. It is an organization of experts and specialists in the Utility field; and they supply service to a large list of client companies. That service covers a wide field, not only accounting, to which I have already referred, but engineering, financing, commercial, legal, and the whole range of services which might generally be considered as requisite to supplement the work of administrative officers.

Q. When did you first consult with Ebasco in relation to the studies required by instructions 2D of the system of accounts?

A. I can't say when that took place.

Q. Would that be approximately the same time that you said you first undertook to approach the task of these studies toward the end of 1937?

A. Well, let's bear in mind that in the rendering of that service, accounting-wise and ignoring the other branches of the service, the service organization makes it a point to have their accounting service men out in the field two or three times a year, sometimes oftener, depending upon how often they are called upon, and whenever they come in, obviously, they sit down and we talk over all of our accounting problems. And [368] while I do not recall the exact date when they may have been in Portland in 1937, they were in Portland during that year and this was a matter, as your may well imagine, of

(Testimony of C. W. Platt.)

major importance to us and would not escape discussion.

Q. Well, in discussing this problem with the Ebasco people, in discussing your problems with them, was it your opinion as well as theirs, that the task of your company was different from the task of other companies which they might service in that your company had constructed all of its property up to January 1, 1937?

A. That fact was recognized and with it the conclusion that it should be a somewhat easier task to find these original costs.

Q. And did you or did you not come to the conclusion that your task was not one of discovering original costs, as defined in the uniform system of accounts, Exhibit 6?

A. No, I don't think that we came to a conclusion that our task was any other than to comply with the requirements of the classification and to find the original costs in accordance with the terms as defined therein.

Q. Well, do I understand that you—you have just testified that you came to the conclusion that your task was one of discovering original costs as defined in the uniform system of accounts prescribed by the Federal Power Commission, Exhibit 6? [369]

A. We saw that as our problem.

Q. And that was when you undertook to prepare yourself for the studies and undertook to make the studies.

(Testimony of C. W. Platt.)

A. I can't say that at the very beginning, as I have related, that we saw the whole problem before us. It was natural that as we progressed we might see new problems, and we had to solve those as we came to them.

Q. Well, I am sure that you must have discussed with your own accounting people and with the Ebasco accounting people—you must have given considerable thought to the fact that the system of accounts speaks of costs and also speaks of original costs?

A. In the case of Northwestern I see no difference between those two trems.

Q. And is that a conclusion that you have come to recently or later, or is that an opinion you have always had?

A. Oh, when I reached that conclusion I just can't say, whether it was something that I picked up upon the first reading of the classification or whether as I progressed in the work and reviewed the studies that were in progress, then went through the classification again to see whether my understanding was correct or not. But whenever the time was, of course I became thoroughly convinced that these two terms were synonymous. [370]

Q. And you became thoroughly convinced that your job was one of discovering original costs as prescribed in Exhibit 6? Or as defined, I may say, rather than described, as defined in the system of accounts prescribed by the Federal Power Commission, Exhibit 6 in this case? A. Yes.

(Testimony of C. W. Platt.)

Q. Now what did you conceive to be your job in this connection in addition to analyzing the charges allocated to the functional fixed capital accounts, under the different classifications and transferring items from one account to another, in accordance with the definition prescribed in the Federal Power Commission's classification?

A. My task was to find out first what the items were that had to be transferred from one account to another. And then to seek information from the books and records of the company as to what the cost of those facilities was.

Q. And do you mean by that statement as to second, your task was to seek information from the books of the company as to what the cost was, that your task was something in addition to transferring items from one account to another and involved possibly the recomputation of the recorded costs of such or of such cost to be recorded of such items.

A. Well, I can't see that there is any way of separating those two things except stating as I have already that the first thing we had to find out was what the items were before [371] they could be reclassified. Then we had to determine the cost of those as best we could from the records available, and then of course there was the further task with respect to the items that required no reclassification but on the other hand had to be examined to determine what their cost was.

(Testimony of C. W. Platt.)

Q. Did you have to discover also the cost of the items which did not have to be transferred from one account to the other?

A. As I just said, that was part of the task, to see that the cost of the items that did not require to be transferred was also carefully discovered.

[372]

Q. Now, isn't it a fact that you advised the Federal Power Commission that the task of your company was not one of discovering original cost as defined in the Uniform System of Accounts, prescribed by the Federal Power Commission?

A. At some point in our correspondence with the Federal Power Commission there was such a letter written, and it was written under conditions which probably had not yet revealed to us the whole extent of our task.

Q. You did so advise the Federal Power Commission?

A. I seem to recall such a letter?

Q. And you advised the Commission that the task of your Company was not one of discovering original cost as defined in the Uniform System of Accounts now prescribed, a year after you had undertaken your first studies in this connection. Isn't that so? A. That is right.

Q. And you had an ample opportunity to consult with Ebasco and other officials, had you not?

A. Yes, there had been ample time for that.

Mr. Slaff: I ask at this time, Mr. Examiner, that a photostatic copy of a letter——

(Testimony of C. W. Platt.)

Q. I show you this letter on the letterhead of the Northwestern Electric Company, Mr. Platt, and ask you if that is a photostatic copy of a letter written by you? A. It is. [373]

Mr. Slaff: I ask that that letter, dated November 25, 1938, be marked Exhibit No. 20 for identification.

(Exhibit No. 20 was marked for identification.)

By Mr. Slaff:

Q. And not only had you had opportunity to consult with the Ebasco people by November 25, 1938, but you had, in fact, consulted with them frequently with respect to your job under Instruction 2-D, of the system of accounts, isn't that so?

A. That is correct.

Q. And at that time the mature judgment of yourself and your advisers and consultants was that your task was not one of discovering original cost, as prescribed by the Uniform System of Accounts, Exhibit 6 in evidence?

A. That is true, but of course not to the exclusion of things pertinently bearing upon the problem which might subsequently seem important to us.

Q. And at that time you stated that, after having stated what your task is not, you stated in the affirmative that your task was one of analyzing the charges allocated to functional fixed capital account under different classifications, and transferring items from one account to another, in accordance

(Testimony of C. W. Platt.)

with the definitions of such accounts in the present classification?

A. That was the statement in the letter. [374]

Q. And that was your judgment at the time?

A. My judgment at the time.

Q. And did you subsequently change your judgment in that respect? A. I did.

Q. When?

A. Well, this letter was written on the 25th of November, and the Company filed its report on or about the 31st of May of the following year. It was some time between those two dates.

Q. Well, I should judge that that would be pretty obvious. And I think we might have been able to infer that without having asked you the question, Mr. Platt. Can you be a little more specific?

A. Well, making the allowance for the necessary time to determine what these restated overheads were and to prepare the report, I should say a month or two before.

Q. According to my file the report was received —well, that would be, then, as of approximately what time, would you say?

A. Well, I should say that possibly it was some time maybe around March or April of that year. Of course——

Q. Of 1939? A. Yes.

Q. You had given considerable thought to the problem [375] by the time you wrote the letter of

(Testimony of C. W. Platt.)

November 25, 1938, which is in evidence as Exhibit 20, had you not?

A. Yes, except that subsequent events showed that I had not explored the problem clear down to the grass roots.

Q. I am trying to find out now with whom you then, after November 25, 1938, proceeded to explore the problem down to the grass roots, as you put it.

A. Well, I talked to our own people in Portland. I don't remember the exact dates when I may have talked to our service organization, but we turn to them for counsel and advice upon problems that are before us, and then I talked also to the men of the industry, because the industry was very much concerned about this, and the farther the industry got into it the more it realized that here was something new, and in the terms expressed by some members of the industry was almost revolutionary.

Q. You say, then, you discussed the problem further after November 25, 1938, with your own people, with the service company people, the Ebasco people, and with other people in the industry? A. That is right.

Q. Those were the three categories generally. Now, was there any suggestion made by any of your own people that you should change your opinion that you have expressed in a letter of November 25, 1938, in evidence here as Exhibit 20? [376]

A. I don't recall where the suggestions came from, whether this matter of treatment came from

(Testimony of C. W. Platt.)

our own people in Portland, or whether in talking to some of the other men in the industry or not. This was discovered, though, and we learned things all the way through this period that were not apparent to us in the beginning, that there were companies, not situated like the Northwestern, who, under force of circumstances, were just going to have to estimate all the costs of many of their facilities; and the further we got in our discussions with men in the industry, that that sort of thing was going to happen, the more we came to look at our own picture and wondered whether in fact our books of account did reflect the full cost.

Q. Of course this change in your judgment and opinion represented a pretty fundamental change, didn't it? A. That is true.

Q. Surely. And that is why I am trying, with your assistance, to see if we can more completely get at what caused that change in your judgment. Now you say you can't recollect any specific suggestion to that effect from any of your own people?

A. I have said that this thing came as the result of many conferences with many people. Just where that thought first developed, I don't know.

Q. Did the Ebasco people suggest the possibility of [377] change in your approach after November 25, 1938?

A. It might have had some influence upon it.

Q. Can you recollect any more definitely whether or not they did, than your statement that they may have?

(Testimony of C. W. Platt.)

A. I don't think that I can be any more definite than I have been, Mr. Slaff.

Q. Now, with respect to your conversations, talks and discussions with other people in the industry at large, I think you had had similar discussions prior to November 25, 1938? A. Yes.

Q. And your discussions with them up to that point, I believe, had not influenced you to the point of view which you subsequently adopted after November 25th? A. That is right, yes.

Q. Now, are you at all familiar today, Mr. Platt, with the facts, or any facts, bearing on the treatment of this problem by electric utilities at large which are subject to the jurisdiction of the Federal Power Commission?

A. Naturally I am in a position to know within what we call the Ebasco, or the Bond & Share system, what some of the other companies in that system are doing, or is being done. And I know from those conversations with the officials of many of these companies that they hold views similar somewhat to my own. I believe that in discussing this with other [378] companies, that there are then those companies—outside of the Bond & Share system, also opinions held that the matter of original cost may have to be established from other records than those heretofore existing as plant ledgers.

Q. Now, confining ourselves for the moment to the Bond & Share system, that is now a system policy, is it not? A. I don't know.

(Testimony of C. W. Platt.)

Q. Do you know of any companies within the Bond & Share system that have not adopted the method which you adopted after November 25, 1938?

A. I do not.

Q. And inasfar as you do know, all companies, or at least all companies of which you know within the Bond & Share system, have adopted the same methods and policies that you adopted after November 25—some time after November 25, 1938?

A. Frankly, I am not very well informed concerning companies even of the Bond & Share system in other parts of the country. I do know that they have, because I have had opportunity to talk to some of their accounting officers. They have been giving this thing very careful attention, and each company has a problem somewhat different from other companies of the system. But each one is trying to determine, quite sincerely to determine, what the cost is of their plant [379] facilities as they interpret this classification of accounts.

Q. And in your judgment wouldn't all the operating companies within the American Power & Light system, and for that matter within the Electric Bond & Share system, be today adopting similar methods to make such determination?

A. Well, they might, if their accounts had been kept in the manner in which the Northwestern has kept its accounts, they might appropriately adopt similar methods.

Q. You don't have much doubt about that, do you?

(Testimony of C. W. Platt.)

A. Well, I will say this, that if there are any companies with problems identical with the Northwestern Electric, I don't see how they can reach any conclusion other than that which we have reached.

Q. Well, do you suppose there are any companies in the company at large with problems, not identical, but substantially similar, at least, to those of the Northwestern?

A. I just cannot claim knowledge wide enough to give you an answer to that question.

Q. Well you, then, would not be prepared to state what has been the position of the industry as a whole in this respect? A. No.

The Trial Examiner: Mr. Slaff, before you go further did you make an offer of Exhibit 20 that you had marked for identification? [380]

Mr. Slaff: I thought I had.

Mr. Laing: We have no objection.

The Trial Examiner: If there is no objection, Exhibit 20 will be received.

(Exhibit No. 20 was received in evidence.)

(Testimony of C. W. Platt.)

EXHIBIT NO. 20

Northwestern Electric Company
Public Service Building
Portland, Oregon
November 25, 1938

Federal Power Commission
Washington, D. C.

Gentlemen:

In your circular letter of September 10 you asked to be informed concerning original cost studies of this company's fixed capital required under the provisions of the Uniform System of Accounts effective January 1, 1937, and prescribed for Public Utilities and Licensees subject to the provisions of the Federal Power Act.

This company was organized in January 1911 and has itself constructed all of the fixed capital which it now owns or has owned at any time since that date. This fixed capital lies in the states of Oregon and Washington and is physically connected between the two states.

The cost of the company's property has been recorded under the several classifications of accounts prescribed by state regulatory authorities beginning in the state of Washington with January 1, 1913, and in the state of Oregon with July 1, 1913. Prior to those effective dates, the record of property costs differed somewhat from subsequent classifications.

(Testimony of C. W. Platt.)

The task of this company is not one of discovering original cost as defined in the uniform system of accounts now prescribed, but in analyzing the charges allocated to functional fixed capital accounts under different classifications and transferring items from one account to another in accordance with the definitions of such accounts in the present classification.

This work is nearly completed and shows more than reasonable indication that if not completed by January 1, 1939, it can be completed shortly thereafter.

Yours very truly,
C. W. PLATT
Secretary and Treasurer

By Mr. Slaff:

Q. Now, coming to specific matters, with respect to the idea of capitalizing interest on cash balances, on cash working capital, did that originate with you?

A. No, it did not. I can't tell you where I picked it up, because, as I say, we have had conversations in our own offices and elsewhere. Of course I can't help making the observation that wherever it was picked up, if I personally subscribe to it I make it my own, and stand responsible for it.

Q. Surely, I assume that you stand responsible

(Testimony of C. W. Platt.)

here for all the testimony which you have given?

A. I do.

Q. I take it with respect to that specific idea or method of restatement of accounts, you did not have that idea prior to November 25, 1938?

A. I did not.

Q. And your answer would apply also, would it not, to the idea of capitalizing interest and taxes on materials and supplies? [381]

A. That is right.

Q. And the same answer would apply, would it not, to the idea of capitalizing administrative and general expenses previously charged to operating expenses? A. That is correct.

Q. Likewise the same answer would apply with respect to capitalizing interest on specific work orders against which interest had not previously been charged? A. That is right.

Q. Interest during construction. Now, as testified to by Mr. Bell, the books of your company have been annually audited by Certified Public Accountants each year; that is correct?

A. That is correct.

Q. Well, at least for some of the years when Bond & Share did the auditing, they were not audited by any outside auditors, were they?

A. They were not.

Q. Your financial reports go regularly, do they not, to State Commissions? A. They do.

(Testimony of C. W. Platt.)

Q. They also go, do they not, to Federal Commissions from time to time?

A. Yes, to some Federal Commissions, and for some periods of time, without specifying when or which ones. [382]

Q. The Federal Power Commission?

A. The Federal Power Commission has had copies of our reports for several years past.

Q. And the Securities & Exchange Commission?

A. Yes, for a short time.

Q. For what?

A. For a short time; a few years; I don't remember just how many.

Q. And they also go to the various financial manuals, Moody, Poor's and others?

A. That is right.

Q. And the stockholders?

A. We sent stockholders an annual report each year.

Q. Which contains, does it not, a copy of your balance sheet and income statement?

A. That is right.

Q. Certified to by a Certified Public Accountant who has made such certification?

A. That is correct.

Q. And some times do your reports go—your financial reports, go to the Bureau of Internal Revenue?

A. We report to the Bureau of Internal Reve-

(Testimony of C. W. Platt.)

nue on the established Federal income tax return forms.

Q. And in connection with your reports to the Bureau of Internal Revenue, are your financial statements submitted [383] to the Bureau or to officials of the Bureau from time to time?

A. Yes, they have access to our books.

Q. And your financial reports go also to the trustees of your bond issue or your bond issues?

A. That is right.

Q. And also from time to time, I take it, to the taxing officials of States or municipalities in which you do business? A. That is correct.

Q. And of course, when you are involved in rate proceedings before regulatory commissions, your State regulatory commissions, your financial statements and reports go to those commissions and are involved very definitely in such proceedings?

A. That is right.

Q. And to a considerable extent, the rates which you are permitted to charge by regulatory bodies depend upon your financial statements and integrity of those statements, do they not?

A. That is right.

Q. I think it is stated in your reclassifications of accounts submitted to the Federal Power Commission, Exhibit 4 in this case, in statement "A" thereof, that every year in the history of the company the company has—— [384]

(Testimony of C. W. Platt.)

A. May I have that page, please?

Q. Surely, page 8. The company has earned annually an amount equal to its preferred stock dividend, plus an amount to make a substantial contribution to surplus, except for the years 1932 to 1934, inclusive—page 8 of the Statement "A", Mr. Platt, that is: the second whole sentence at the end of the first paragraph. You might read that statement——

A. That is right.

Q. And during all of that time your company has been under regulation by rate regulatory authorities.

A. That is right.

Q. To anyone looking at your financial statement and attempting to draw conclusions from it, the relationship of your net revenue to your fixed capital is a most important matter, is it not?

A. A very important matter.

Q. And, of course, if your operating expenses have been over-stated, you have understated your net revenue?

A. That would follow.

Q. And of course if your net revenues were understated, the percentage relationship between your net revenues and your fixed capital was understated —that is, I mean, your net returns, the percentage was understated?

A. That likewise follows.

[385]

Q. Now, all the various agencies and persons to whom your financial statements have gone in the past, and to whom they go now, of the types that we have mentioned here, have a very definite stake

(Testimony of C. W. Platt.)

in understanding and know that your statements are true statements? A. They have.

Q. And you would agree, I am sure, with the statement that uniformity of treatment is basic to sound accounting practices?

A. Basic but not all-controlling.

Q. Well, at least we are agreed as to the fact that it is basic?

A. I just don't want to give too broad an interpretation to your term "basic". I think that it is correct to say that it is basic, but I want to make sure that we understand that there are controlling factors in the determination of that fact.

(Whereupon, a short recess was taken.) [386]

The Trial Examiner: The hearing will be in order.

Q. Mr. Platt, have you changed your mind since the adoption of the uniform system of accounts, Exhibit 6 in evidence, as to what constitutes constituents or elements of cost of plant?

A. I have changed my opinion as to what is good practice and sound practice.

Q. Well, when you say that you mean you have changed your opinion as to what should be recorded as cost of plant? A. Yes.

Q. Have you, however, changed your opinion as to what constitutes the elements or components of cost of plant?

A. I will put it this way, if I may. First, let me say that I have heretofore indicated I have been in

(Testimony of C. W. Platt.)

utility accounting for 31 years, and the field of utility accounting has broadened immensely in that period. Continuously during that time we have had occasion to adopt different methods of accounting, to look at things through new eyes, and to do things that years ago we probably would not question. Now, we find ourselves today with this Federal Power classification before us, with more definiteness to it than any classification we have had before, and we are required to subscribe to it; and I find no fault with these definitions of cost. They are a little more exhaustive than heretofore, and I believe they are accurately stated and [387] the employment of them will give the utilities costs which are accurate and for the moment we will say,—not knowing what the future may have for us,—definite and accurate costs.

Q. Then do I understand that you are telling us that the Federal Power Commission's system of accounts sets out no new elements or components of cost, but merely in some instances clarifies or makes more definite the definition of elements of cost to utility plants?

A. I think that is a fair way to put it.

Q. You, however, to get back to where we started from after recess here, haven't changed your mind as to what constitutes components of cost, have you, —of cost of plant?

A. Well, if we are speaking now in terms of such component costs as labor and materials and insurance applicable thereto and interest and of these accounts recited in plant instruction——

(Testimony of C. W. Platt.)

Q. Is it 5?

A. 5, I don't believe there are any new elements of cost which have not heretofore received some recognition.

Q. And, as a matter of fact, the components of cost set out there, which might be classed as overhead cost, are very closely similar to the components previously set out in the definitions, or very closely similar to the components previously set out in the system of accounts of the State of [388] Oregon and the State of Washington, under which you have operated?

A. As I recall it, the same components of costs are enumerated in those prior classifications.

Q. Do you have before you the Oregon System of Accounts, effective January 1, 1925, Exhibit 19 in this case? A. Yes, I do have.

Q. And do you have before you, also, at this time the Federal Power Commission's System of Accounts, Exhibit 6? A. I do.

Q. Turning to Instruction 5 of the Electric Plant Account Instructions of Exhibit 6, and accounts beginning with Account 351 of the fixed capital accounts of Exhibit 19, Instruction 5 (8), that instruction compares, does it not, with Account Instruction 353 of Exhibit 19?

A. I am sorry. I did not get your reference.

Q. 5 (8) Injuries and Damages——

A. Would you like me to tell you whether there is any material difference?

(Testimony of C. W. Platt.)

Q. No. I think that that would probably appear from the account. But I would just like to get your statement that they are comparable accounts or comparable definitions, so the record may be complete.

A. From the titles, they seem to be.

Q. And in text they are comparable, are they not? [389]

A. Without reading them closely, I fail to see any material difference.

Q. And Instruction 5(11) of Exhibit 6 is comparable to Account 351 of Exhibit 19, is it not, Engineering and Supervision?

A. They are comparable.

Q. And Instruction 5(12) of Exhibit 6 is comparable to Account 356, is it not?

A. There is no substantial difference, I believe, except that there might be ground for some question where it says, under Account 356 of the Oregon classification: "This account shall include the salaries and expenses of the general officers of an electric plant under construction." That might be considered to be a plant under initial construction.

I think that is probably going a little far afield to find fault with it, but I would like you to turn, in that connection, to Account 781.11, which is "Administrative Salaries." There is a little more of doubt thrown into the situation there, where it states, "This account shall include the salaries of the Chairman of the Board, President, Vice-President, Treasurer, Secretary, Comptroller, General

(Testimony of C. W. Platt.)

Auditor, General Manager, Assistant General Manager, Chief Engineer, General Superintendent, Purchasing Agent and all other employees whose jurisdiction extends to the entire system and whose services cannot be allocated to the sever- [390] al departments."

Q. Now, does that differ in any way?

A. I don't know exactly what that means, whether that means "departments" as frequently used in the text elsewhere, referring to departments such as the Electric Department and Gas Department and a Water Department.

Q. Or Construction department?

A. It might be.

Q. Or operating department?

A. It might be.

Q. Does that account 781.11 differ materially, in your judgment, from Account 790 of Exhibit 6?

A. Account 790 can have said for it, as can many other accounts in this new Federal classification, that it is much more definite in character because it says there that: "This account shall include the compensation (salaries, bonuses, and other considerations for service) of officers and executives of the utility, properly chargeable to electric operations and not chargeable directly to a particular electric function."

Then I think it would be well to go back to General Instructions, Instruction 11: "The charges to electric plant, operating expense and other accounts

(Testimony of C. W. Platt.)

for service and expenses of employees engaged in activities chargeable to various accounts, such as construction and operation, shall be based [391] upon the actual time engaged in the respective classes of work or, in case that method is impracticable, on the basis of a study of the time actually engaged during a representative period."

That again makes the account 790, in my opinion, somewhat clearer.

And then in that connection I would like to refer to 781.12 in the Oregon classification. [392]

Q. The other is general office salary?

A. The other is general office salary. This account shall include the salaries of auditors, bookkeepers, cashiers, paymasters, stenographers, clerks, employed in counting cash, janitors, porters, messengers and other clerks and employees whose time is devoted to the work of the general office. There is no specification in there providing—providing as in account 781.11 the allocation to several departments.

Q. I see. And it is your opinion that account 791 of exhibit 6 is the more definite of the latter two?

A. Yes. And while we are on the subject, because I am responsible for bringing up this question indefiniteness in prior classifications is one of the reasons why our company, and I am inclined to think it is applicable to many other companies, have not been as careful as we should have been in allocating these costs.

(Testimony of C. W. Platt.)

Q. You mean have followed the conservative practices that you have?

A. I don't like that word "conservative".

Q. That was Mr. Bell's word.

A. I think it was. I am not so sure but what I used it in my testimony; but reading that testimony over afterwards I wasn't quite taken with it.

Now let's refer to the uniform accounts required for licensees under the Federal Power Act. It is, nevertheless, [393] the system of accounts that was applicable during this period under discussion, although it may have been superseded.

The Trial Examiner: I think, Mr. Platt, perhaps you had better return to the witness stand.

The Witness: I thought there might be some question in the absence of another copy of this, whether the text was exactly as I am going to read it.

Mr. Slaff: What classification are you now referring to, Mr. Platt, in your testimony.

A. System of accounts prescribed for licensees under the Federal Power Act, stated as the first issue, November 20, 1922.

Q. Your company was not subject to that classification, was it? A. No.

Q. You were not a licensee?

A. No, but I am referring to this as having a bearing on the interpretations which we have made.

By Mr. Gray: Who was that prescribed by, Mr. Platt?

A. The Federal Power Commission. I am refer-

(Testimony of C. W. Platt.)

ring to account 395 "Miscellaneous Construction Expenditures". "Charge to this account the items designated in the following subheads: (a) General Officers and Clerks. This account shall include the pay of general officers and general office clerks [394] engaged exclusively in connection with the construction of original plants or additions thereto. Also the expenses of such employees incurred solely on account of such construction work, even though not engaged exclusively in such work. There may also be charged to this account——"

Q. It is a fact, is it not, Mr. Platt, that that system of accounts had to follow the Interstate Commerce Commission system of accounts?

A. It did, which probably adds somewhat to its stature for the purpose for which we are considering it.

Q. Now for what purpose have you considered it?

A. In trying during this period under review of 1926 to 1936 to arrive at a proper method of handling these administrative and general expenses.

Q. Do you mean during that period from 1926 to 1936?

A. That is it.

Q. Now, turning back to Instruction 5 (15) that is comparable, is it not, to plant account Instruction 5 (15) of Exhibit 6 is comparable, is it not, to plant account 352 of Exhibit 19?

A. I see no substantial difference.

Q. All right. Now leaving that for a moment, you testified with respect to your item of interest

(Testimony of C. W. Platt.)

during construction as follows, at page 84, referring to the Examiner's recommendation of the reversal of charge to electric plant [395] in the amount of $34,959.79, you testified "this is interest during construction on specific electric plant construction charges during the year 1914 to 1924, inclusive, during which period interest was recorded on only a limited number of jobs and through accounting error the recording of this item of cost was omitted entirely." You so testified, did you not?

A. I did.

Q. The interest during construction had been regularly recorded, had it, up to 1914?

A. July 1, 1914.

Q. And after 1924 was interest during construction recorded and charged to plant account?

A. Will you repeat that question, please?

(Question read.)

A. Yes, it was. I am not sure whether one or more of these orders that are referred to in this testimony may not have fallen within the year 1924. I am assured that there is no duplication.

Q. During the year 1918 interest during construction was charged in connection with the construction of the Lincoln plant?

A. That is right.

Q. And do you know the amount of interest during construction? A. I do not. [396]

Q. Approximately $37,000.00?

A. I do not know.

(Testimony of C. W. Platt.)

Q. Well, in any event that charge of interest during construction in 1918 in connection with the construction of Lincoln represented a deliberate choice on the part of the management, did it not?

A. Certainly.

Q. And there was similarly a charge to interest during construction in connection with the Lincoln plant in 1924, was there not?

A. I don't know.

Q. Now an audit of the fixed capital accounts of the company was made by the Oregon Commission staff in 1931 and 1932 as of December 31, 1931, was it not? A. Yes.

Q. And that was in connection with a rate case then pending before the Oregon Commission?

A. It was a case in which there was involved a matter of the determination of a value, and I forget whether it developed into a rate case or not, at any rate it had the general aspects of a rate investigation.

Q. And certainly you will agree that the audit was for the purpose of determining whether the amounts included in the company's fixed capital accounts from the inception of the company were proper capital charges and whether they [397] were properly classified.

A. The staff of the Oregon Commission made that audit.

Q. Yes.

(Testimony of C. W. Platt.)

A. And gave us its conclusion and a report of its findings.

Q. Well, with respect to the audit itself, regardless of what conclusions may have been drawn from the audit or the purposes to which the audit might subsequently be put, I think you would agree, wouldn't you, with the statement that I just made that the purpose of the audit was to ascertain whether the amounts contained in the company's fixed capital account were proper capital charges and whether they were properly classified?

A. That was the purpose, but it was evident that the purpose was not fully accomplished.

Q. Well, we will come to that. At least, we will agree that that was the purpose, at this stage, will we not? A. Yes.

Q. And a great number of adjustments resulted from that order, did they not?

A. They did, the bulk of them, it might be in order to state had to do with reclassification between functional fixed capital.

Q. Transfer between accounts?

A. Yes, because the company had started under a [398] system of accounts that was not currently applicable.

Q. That is right. Started under the 1915 system and the system then in effect was the 1925 system, which is now exhibit 19 in evidence?

A. That is right.

(Testimony of C. W. Platt.)

Q. Adjustments were made by the company, were they not, in accordance with the order?

A. That is right.

Q. I think you said so.

A. That is right.

Q. And in 1936 and 1937 a further audit was made by the staff of the Oregon commission, was it not? A. That is right.

Q. And adjustments were made after that audit, were they not?

A. I don't remember just what grew out of that audit, by the way of adjustments.

Q. Well, in connection with those audits or as a result of those audits or after those audits, were any restatements made of interest during construction by your company on its books?

A. Not that I recall.

Q. Nor were any restatements made of administrative expense or general expense or similar items previously charged to operating expense accounts?

A. No. [399]

Q. You did not conceive the fact that interest during construction was not charged during the period 1914 to 1924, inclusive, except that it was specifically charged in 1918—you did not conceive that fact to be an accounting error when you reviewed the audit made to the Oregon Commission staff in 1931?

A. The fact, as far as I know, was not developed.

(Testimony of C. W. Platt.)

Q. Well, you were aware of the fact, were you not? A. I was not.

Q. Do you mean to tell us, Mr. Platt, that from 1925 to 1937 you were not aware of the fact that interest during construction had not been charged by Northwestern Electric Company to 1924 and 1925?

A. You must remember that I was not associated with the company during that period.

Q. I realize that fact, and I am asking you now if that is what you mean to tell us?

A. That is right. I was not aware of the fact.

Q. When did you become chief accounting official of the Northwestern Electric Company?

A. In March of 1925.

Q. And did you at that time make any attempt to review the previous accounting practices of the company?

A. I don't recall just the extent to which I went at that time in connection with the records of the Company that [400] I became responsible for. I do know this, that within the year 1925 I instructed the accounting officer under me, who was in charge of the books and records in another building, by the way, that he was to pursue the same course that we were following with our other companies, and included, of course, the capitalization of interest.

Q. Did the Northwestern Electric Company retain any of its accounting employees?

(Testimony of C. W. Platt.)

A. It retained a man who, under the former management, was designated as the auditor, and later as assistant secretary-treasurer—assistant secretary and assistant treasurer for a period of some months—I don't know just how long he remained before he resigned and went to another position. Maybe six months or thereabouts. And thereupon I sent to that office a man who had been associated with me in my other office, and told him to put into practice the same methods of accounting that we had been accustomed to.

Q. Mr. Platt, didn't you feel any responsibility to determine the methods and practices of the management up to the time you stepped into that position?

A. Well, if you want to put it that way, and obviously you do, when it comes to this matter of interest during construction, it just never occurred to me that the Northwestern Electric Company had failed to follow every common and correct practice in that respect. And I did not go back, nor author-

[401] ize anyone else to go back, to develop these things.

Q. And the fact is, then, that when the audit was made by the Oregon staff in 1931 and 1932, and you and your staff reviewed that audit, and the result, you were still unaware that there had been no capitalizing of interest during construction, during the period 1914 to 1924, with some few exceptions? A. I was.

(Testimony of C. W. Platt.)

Q. And that is likewise true, is it, when you reviewed the audit made by the Oregon Commission in 1936 and 1937?

A. I was still unaware.

Q. And when did you first become aware of the fact that interest during construction had not been charged during the period 1914 to 1924, inclusive, except with respect to the Lincoln plant?

A. Some time subsequent to November 25, 1938.

Q. How did you become aware of that then—who called it to your attention?

A. Because, as I have heretofore testified, the farther we got into this matter of reclassification and statement of original cost, the more exacting we became in the scrutiny of our records. And while I do not know exactly how it happened, I fancy that in our discussions I said to the accounting staff, "Well, now, let us look at this interest during construction, and see if it has been handled right [402] in the past," because we were just scrutinizing all of our cost as recorded to determine whether or not—in order that we could make a return to the Federal Power Commission that was fully inclusive of all of the original cost of our properties.

Q. Now, you had no—I think you have testified, of course—had no connection with the company prior to 1925? A. That is right. [403]

Q. Weren't you requested, very early after you took office with the company, by the Bond & Share

(Testimony of C. W. Platt.)

Company, to make an audit of the Northwestern Electric Company?

A. Requested by the Bond & Share Company to make an audit?

Q. Yes.

A. I don't know of any such request.

Q. Perhaps we can refresh your recollection. Who is Mr. Brewster?

A. Mr. Brewster was at one time the general auditor of the Electric Bond & Share Company.

Q. And did he not, in July of 1925, request you to make an audit of the Northwestern Electric Company?

A. I don't recall that he did. Furthermore, I am not just sure what particular authority—if the question [429] of authority is involved in the matter—Mr. Brewster had in the matter.

Q. The question of authority at this moment is not involved, Mr. Platt. If you received, in 1925, however, a request for an audit from the Chief Accountant Officer of the Electric Bond & Share Company, you would not have disregarded that request and failed to answer the letter, or anything of that sort, would you?

A. I think that would have received some attention.

Q. Indeed, yes.

A. But to my recollection these many years afterward, I do not know what attention, if any, it got, and I can assure that neither myself nor any

(Testimony of C. W. Platt.)

other employe of the company went back into the fixed capital accounts in an auditing fashion to determine just what lay therein. But I can't help but make this observation while we are on the subject, that I fail to see how the time when a discovery was made that these charges had not been put on the books affects their materiality. I want the record to show that.

Q. Well, I know you fail to see that, Mr. Platt. But we need not go into that at this moment. However, to get back to 1925, back of that time, did you testify before the Oregon Commission, at page 1223 of the transcript of evidence in that case, designated "UF 526", which we discussed [430] previously, "The Witness: Will you read the question? Mr. Clark: Perhaps I can get it. July 30, 1925, is a letter from you to Mr. Brewster, Assistant Auditor of the Electric Bond & Share, evidently in response to a wire he sent you, requesting that audit be made of the Northwestern Electric Company, and you say that Mr. Wilkinson replied to the wire, in your absence, and that you wished to confirm that it will be altogether satisfactory to undertake an audit at this time. Were the accounts audited? A. The accounts were not audited from the inception of the company's business, and the reason—— Q. And you—— The Witness: Let me complete this, will you please? Mr. Clark: Certainly. A. And the reason they were not was the accounts of the company had been audited year by year for a

(Testimony of C. W. Platt.)

number of years by Haskins & Sells, a firm of certified public accountants of national repute, and we placed considerable reliance upon the reports which they issued." Do you remember so testifying?

A. I don't, but the facts as you have stated them are sufficiently accurate that I think we can accept them for this purpose.

Q. Then the reason that you did not make the audit as requested was that you relied upon the audits previously made by Haskins & Sells. That is correct? A. That is right. [431]

Q. Now, it appears from those audits made by Haskins & Sells to any good accountant who looks them over, that interest during construction was charged during certain of the years, and interest during construction was not charged during other years. Isn't that so? A. That is correct.

Q. You have examined those audits of Haskins & Sells?

A. Yes, I gave them some examination. How much, I don't know.

Q. You examined them as Chief Accounting Officer of the Northwestern? A. Yes sir.

Q. And was, or should it have been apparent to you, as a good accountant, that interest during construction had been charged during one or more of the years during the period of 1914 to 1925, and had not been charged during other of those years?

A. I don't know whether that was in the auditor's report or not.

(Testimony of C. W. Platt.)

Q. I hand you a document consisting of several pages, and ask you what it is.

A. This is an audit report by Haskins & Sells, for the year ending December 31, 1920.

Q. And where does that audit report which I have just [432] handed you come from? It comes from your files, doesn't it? A. It does.

Q. Turned over to us by your office on Monday morning, with other papers?

A. That is right, yes.

Q. Now, does it not appear on the comparative statement on the income and profit and loss for the year ending December 31, 1920 and 1919, Exhibit "B", attached to that audit, that during the year 1919 interest during construction, in the amount of $49,955.00 was charged to capital, and during the year 1920 no interest during construction was charged to capital? A. That is right.

Q. And that is set out explicitly, as I have just put it to you, on that exhibit? A. Correct.

[433]

CHARLES W. SMITH,

produced as a witness on behalf of Federal Power Commission, being first duly sworn, testified as follows:

Direct Examination

By Mr. Slaff:

Q. Mr. Smith, will you give your full name to the reporter? [467]

(Testimony of Charles W. Smith.)

A. My name is Charles W. Smith.

Q. What is your position?

A. I am Chief of the Bureau of Accounts, Finance & Rates, of the Federal Power Commission.

Q. Will you please state now your background of education and experience relevant to this proceeding?

A. I have a B.S. degree in finance and business administration and, also, hold an L.L.B. degree. I am a certified public accountant of North Carolina and of Maryland, the first having been obtained about eighteen years ago. I am a past president of the Maryland Association of Certified Public Accountants and a member of the American Institute of Accountants, the American Accounting Association, the American Economic Association, the American Bar Association, and an honorary member of Delta Sigma Pi, an international commerce fraternity, and Beta Alpha Psi, a national accounting fraternity. I am also a member of the Committee on Statistics and Accounts and of the Committee on Depreciation of the National Association of Railroad and Utilities Commissioners. I have been admitted to bars of the Court of Appeals of Maryland and the Supreme Court of the United States.

Q. How long, by the way, have you been a member of the two committees of the National Association of Railroad and Utilities Commissioners? [468]

A. I was a member of the Committee on Statis-

(Testimony of Charles W. Smith.)

ties back to 1933 or 1934, I believe. In 1935 I resigned my membership because I was associated with the Federal Power Commission, and the Chief Accountant of the Commission was also a member of that committee, and I didn't think two of us should represent the same agency. I became again a member of the committee in about 1937 or 1938. I have been a member of the depreciation committee for two years.

Q. Will you continue, please?

A. For nine years I was an auditor in the Income Tax Unit of the U. S. Treasury Department and, in this capacity, I audited the income tax returns and books and records of practically every type of business corporation, including public utilities. On June 1, 1929, as the result of obtaining the highest mark in a competitive examination, I became the Chief Auditor of the Public Service Commission of Maryland, remaining in that position for seven years. I joined the staff of the Federal Power Commission on July 1, 1936, in substantially my present capacity.

Q. The title was something else at the time you joined, but the duties were substantially the same?

A. The duties were substantially the same. Since I joined the staff of the Commission more work has been transferred to me from other divisions, as a matter of fact, but my duties are substantially the same as when I [469] first went there.

Q. Proceed.

(Testimony of Charles W. Smith.)

A. For ten years I taught accounting in evening schools in Baltimore, including eight years at Johns Hopkins University when I gave the course in accounting systems and for two years the course in cost accounting. These courses were for both day and evening students.

While with the Maryland Commission, I did a good deal of work as consultant in accounting, taxation and finance in my spare time. On one occasion I obtained leave of absence to do some consulting work for the Tennessee Valley Authority and on two other occasions I was granted leave to act as consulting accountant to the Federal Power Commission.

Q. What was the nature of your consulting work for the TVA?

A. It was for the purpose of reviewing the accounting system of TVA, and reviewing a proposed new system which TVA proposed to install.

Q. And with consulting that you did with the Federal Commission and while with the Maryland Commission?

A. On the two occasions I was retained by the Federal Power Commission as a consultant, I supervised the drafting of a uniform system of accounts, which the Commission later prescribed for public utilities, the system which is involved [470] in this proceeding. I have also obtained one leave of absence from the Federal Power Commission to act as consultant to the Civil Service Commission of New

(Testimony of Charles W. Smith.)

York in connection with the grading of senior public service commission accountants and rate case experts.

I have written several articles on accounting and economic subjects, including a text on accounting systems for my classes at Johns Hopkins. I understand that the latter text is still being used. I have delivered a great many lectures, more than fifty, on accounting, financial and economic subjects, including two radio addresses.

While in the employ of the Public Service Commission of Maryland, I had charge of all accounting, auditing and financial matters which were under the jurisdiction of that body. This included the making of the usual accounting investigations for all regulatory purposes, all studies relating to the issuance of securities, financial structures, rate of return, and so forth.

In my present position I have charge of four divisions of the Federal Power Commission, namely, the Division of Accounts, Division of Finance and Statistics, Division of Rates and the Division of Original Cost. I organized the Division of Original Cost for the Commission and have participated most actively in supervising the work of that division. For instance, Mr. Van Scoyoc, Chief of that Division, [471] and I determined jointly when the reclassification study of the Northwestern Electric Company should be investigated and we determined jointly the man who should be in charge of the field

(Testimony of Charles W. Smith.)

work. I have kept in close touch with the work since it started.

Q. And in connection with your duties for the Federal Power Commission, do you have duties in connection with interpreting the system of accounts regularly?

A. Yes, I issue interpretation of the system of accounts over my own signature.

Q. Those go to your staff people and others on the staff of the Commission?

A. They go to the staff of the Commission, and they go to the utilities as well. [472]

Q. Would you be good enough to discuss, Mr. Smith, in a rather broad and general and concise way the general nature of accountings?

Mr. Priest: What was the question?

Mr. Slaff: Discuss the general nature of accounting.

A. Accounting, in brief, deals with proprietorship and its changing amounts. This involves, more than anything else, the assigning or allocating of costs to, or the matching of costs with, revenues. Although employing myriad details in its process and giving much information to management and others as a by-product, essentially cost determinations,—the cost of doing business,—the cost of procuring revenues,—the resulting profit or loss,—are the chief aims and purposes of accounting.

Accounting is not an exact science. This is admitted by all who are trained therein. Its prin-

(Testimony of Charles W. Smith.)

ciples and practices are grounded on convention, tradition and logic.

By Mr. Slaff:

Q. What would you say are the two chief financial statements prepared by accountants?

A. The two chief financial statements prepared by accountants are the balance sheet and the income, or profit and loss, statement. These statements (they may be supported ad infinitum with schedules of details) are indissolubly related and this relationship is always present, consciously [473] or unconsciously, in the mind of the accountant. A charge may be recorded in an account of either but not simultaneously in both. Charges are very often made to balance sheet accounts and then prorated or allocated to income accounts of different periods. This process is going on all the time as one of the routines of accounting. It is important that we do not forget the relationship of the two statements by focusing attention exclusively on only one. Such half-thinking may result in grave distortions.

While accounting is not an exact science, it is, nevertheless, a well-developed science. Its mechanisms are necessarily very complex for a large organization. The mechanics of accounting are anything but uniform. As to its broad, fundamental principles, however, the science of accounting is pretty much the same everywhere, but even these broad, fundamental principles are not inflexible in

(Testimony of Charles W. Smith.)

detail. Rather, much choice and much discretion are permitted within the scope of these broad principles. Thus, it is a fundamental principle of accounting that inventories, where they exist, must be included in the balance sheet and income statements. The methods of pricing the inventories, however, are subject to a great deal of variation, a great deal of discretion and choice. Department stores, for instance, use a statistical method in pricing inventories; some businesses use the first-in, first-out basis, whereas others use the last-in, first-out [474] scheme. Some businesses value inventories on the basis of cost or market, whichever is lower, whereas others use cost and, in some cases, where costs cannot be obtained, market value, less estimated selling costs. The Federal income tax regulations permit wide discretion in pricing inventories, but no change in method may be made without permission of the Commissioner of Internal Revenue.

In the extractive industries, it is a good accounting practice to charge substantial replacements of plant to expense, just the same as in many jurisdictions it is good law for the extractive industries to pay dividends out of capital. In fact, these industries generally charge items to expense which would likely be charged to capital or plant accounts in other business enterprises, because of the nature of their undertakings. There is good reason for this, of course, and the practice, if consistently fol-

(Testimony of Charles W. Smith.)

lowed, yields satisfactory and sound accounting results.

Public utilities are noted for their large investment in plant assets. A tremendous amount of accounting revolves around such assets. Considerable discretion has been allowed and is still allowed management in accounting for such investments, although the tendency of regulatory commissions is to restrict the area of choice.

While considerable variation has existed in the accounting treatment of plant items, accountants have not hesitated [475] to certify to statements of different companies which have used different methods. They are right in doing so because the general or accepted principles of accounting do not lay down one and only one inflexible rule. Different practices may be right, if they are within the limitations of the broad scope of an accounting principle.

The reason for this condition is that accounting, to reiterate, is not an exact science.

A. (Continuing) As to many items which are charged to the accounts, the question is not so much what is right or wrong, but, rather, what is the better practice; and the treatment of many individual items is not nearly as important as consistency in the treatment of such items.

Consistency is an important word in the terminology of accounting. When an accountant certifies to a financial statement he invariably makes

(Testimony of Charles W. Smith.)

the positive assertion that the financial statement is in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such a positive assertion is contained in the certificate approved by the American Institute of Accountants. The latter certificate is in widespread use, [476] as reference to the annual reports of almost any corporation with listed securities will disclose.

It is vital to the integrity of financial statements that the accounts which underlie them be kept in accordance with consistently applied principles, for otherwise distortion and manipulation, consciously or unconsciously, result. In fact, consistency is so important that any departure therefrom in published financial statements must be called to the attention of the reader, if justice is to be done.

In other words, there are accepted principles of accounting but considerable discretion is allowed within the scope thereof, provided the discretion is not abused by inconsistent application. [477]

Q. Now accountants are constantly making determinations of costs, are they not?

A. Yes, accountants are always dealing with and making findings of costs.

Q. Do they usually determine exact or precise costs in their work?

A. Except in very rare cases, the exact or precise cost of anything, of any substantial item of plant, any major service that is rendered, cannot

(Testimony of Charles W. Smith.)

be computed. Reasonably accurate answers only can be obtained; but, for all practical purposes of accounting and finance these suffice.

Q. Now will you explain the reasons for this last answer that you made?

A. Cost is not, in most cases, a simple thing. It is a complex thing. Many costs are joint costs in one way or another, that is to say, they consist of expenditures incurred for two or more items or services. Certain costs in manufacturing industries are sometimes allocated to a great many, even hundreds, of products. The costs of hauling different classes of freight by railroads is a problem of joint costs which still largely awaits solution. The cost of distributing electricity is so difficult of determination that only three or four such cost studies have been published in this country. The reason is joint costs.

The most discussed joint costs are overheads or [478] indirect costs. Overhead or indirect costs are costs which cannot be said to be incurred directly and solely for an individual item or function. Accordingly, overheads must be allocated or prorated on some basis to the items or functions to which they relate.

There is no one and only one acceptable method of allocating or prorating such overheads. Many schemes are resorted to. Great choice is allowed in this field of accounting. No system of accounts

(Testimony of Charles W. Smith.)

prescribed by any regulatory commission, to my knowledge, lays down the bases or methods which must be followed in making distribution of overhead expenditures. It is important that the method of allocation be equitable and that reasonably accurate accounting results be obtained. But further than this, the systems of accountants are silent.

Q. Would you say, for instance, that it is necessary to have uniform treatment of general administrative expenses?

A. It is not necessary, under accepted principles of accounting, that such items, for instance, as general and administrative expenses, be classified as overheads at all. When an industrial or commercial concern constructs a new plant, it does not usually include in the cost thereof any amounts for regular officers' salaries, even though officers whose compensation is normally charged to the general, administrative group of expenses spend some time in supervising [479] the construction work. The classification of accounts prescribed by the Interstate Commerce Commission for steam railroads does not permit the allocation of general, administrative expenses to construction. General and administrative expenses go on pretty much in the same amount whether or not construction is in progress, and there is good logic to support the principle that only such part thereof as is specifically incurred for construction purposes should be capitalized.

(Testimony of Charles W. Smith.)

Considerable discretionary latitude is allowed management under the Federal Power Commission's systems of accounts for electric utilities in accounting for general and administrative expenses. The practices of utilities in this matter vary considerably. In some instances no part of such expenditures is capitalized as a part of the cost of plant items, whereas in others, a part of such expenditures is allocated to plant, but the methods of allocation lack uniformity.

Q. Now, when overheads are once accounted for as an operating expense, is it good accounting in subsequent accounting periods to reaccount for them as plant costs?

A. I believe it absolutely wrong to sanction reaccounting for overhead items so as to permit a part thereof to be included in plant accounts when the entire amount was previously charged to expense. There was no accounting error if the amounts were originally charged to expense. It is not [480] a correction of an accounting error, therefore, to reaccount for such items by now including them in plant. Such re-accounting, in my opinion, is simply a means of inflating the accounts.

I have already indicated the large investment of utilities in plant assets. Utilities are almost constantly making additions and betterments to their properties. Plant costs, therefore, are almost always being incurred. At the same time, operating

(Testimony of Charles W. Smith.)

expenses are being incurred. Some of the expenses are joint, that is to say, they relate to both plant and to operations. Plant costs are merely deferred operating costs; they become operating costs through depreciation charges. Considerable accounting and managerial discretion is, and I believe must be, allowed in assigning the joint costs to the respective functions. This follows because the problem, as I said before, is not capable of precise solution. We necessarily must be somewhat arbitrary in order to achieve workable results. Reasonably accurate answers, again to reiterate, are all that should be expected in this field, and certainly all that can be obtained.

When such reasonable answers are obtained, they should have a large degree of finality, for otherwise great doubt will be cast upon the integrity of financial statements, and great mischief may be done. Past accounting [481] should not be impeached because someone at some other time thinks a different answer is better. Re-accounting of this nature offends the sound principles of accounting. This is obviously so, for otherwise, as indicated by the California Railroad Commission, every time a new face appears on the scene, re-accounting could be had. There would be no surer way of destroying the usefulness of accounting for regulatory purposes.

Re-accounting by which amounts previously charged to expense, under the system of accounts which permitted such accounting or under the dis-

(Testimony of Charles W. Smith.)

cretion of management, in accordance with accepted practices of the time, are now sought to be charged to plant, is, in my opinion, particularly bad accounting. If an item is once charged to expense it should not be charged to expense again through depreciation of plant accounts unless an obvious error was committed in the first instance. The treatment of joint and replacement costs in accordance with good authority and practices of the time are clearly not such errors. [482]

Q. What was the primary innovation accomplished by the System of Accounts in regard to plant accounting?

A. The system of accounts made certain innovations in regard to plant accounting, primarily by including provisions relating to what is known as the "original cost doctrine".

Q. Why was the original cost principal recommended by you?

A. In order to understand the underlying principles of the original cost provisions, the condition of electric utility accounts prior to the adoption of the new system must first be known. It will be recalled that the Federal Trade Commission, pursuant to a resolution of Congress, made a comprehensive investigation of the electric utility industry. The most notorious disclosures made by this investigation related to the enormous amount of inflation in the accounts of electric utilities. This inflation had come into the accounts of operating utilities

(Testimony of Charles W. Smith.)

primarily through direct write-ups and through acquisitions of operating properties by one utility from another, either directly or indirectly. It was recognized, after the disclosures of the Federal Trade Commission, that certain accounting reforms had to be resorted to if the condition was to be corrected.

In many cases the accounts of electric utilities, prior to the adoption of the new system of accounts, contained no breakdown of plant costs by accounts, it being impossible to ascertain the investment by utility departments, such as [483] gas, street railway, electric, etc., much less the cost of generating stations, transmission lines, etc. This, of course, was a great handicap to regulation. Public Service Commissions, likewise, were troubled by the fact that often properties were purchased on an over-all basis and then an appraisal was resorted to for the purpose of recording individual plant items. To illustrate this point, the appraised value of a generating station might be recorded on the books and when an audit was made, only the ex parte appraisal was available. We knew that ex parte appraisals were wholly unreliable,—thus vital information essential to the proper regulation of public utilities was not obtainable. The foregoing were among the reasons I believe which lead the National Association of Railroad and Utilities Commissioners to instruct its Committee on Statistics and Accounts to prepare a new system of accounts.

(Testimony of Charles W. Smith.)

When public service commissions are created, one of their first actions is, generally, the prescribing of systems of accounts for utilities under their jurisdiction. Proper accounting is essential to the proper regulation of utilities. In fact, I believe accounting is the backbone of rate and financial regulation of utilities. When the condition of accounts prior to the adoption of the new system is fully appreciated and the importance of accounting is recognized, the purposes of the provisions of the new system of accounts [484] relating to plant accounting will, I believe, become evident.

Q. How did the accountant who prepared the system deal with this problem?

A. The Committee on Statistics and Accounts in collaboration with the staff of the Federal Power Commission, in tackling this problem, concentrated, after prohibiting direct write-ups, on properties acquired by one utility from another. It is in this connection that the term "original cost" is used. The system of accounts provides that if "operating units or systems" are acquired they shall be included in the plant accounts at cost to the person first devoting the property to public service and the difference between such cost and the cost to be accounting utility shall be included in a separate, earmarked account known as Account 100.5, Electric Plant Acquisition Adjustment Account. It will be noted that the title of the latter account connotes acquisitions. It is in connection with acquisi-

(Testimony of Charles W. Smith.)

tion of operating units or systems that amounts shall be recorded in Account 100.5.

There is no authority in the system of accounts which would permit a utility to re-account for its own construction costs on some new theory or principle. The cost of purchased property constituting operating units or systems is required to be segregated between the cost to the person first devoting [485] the property to public service, which is referred to as original cost, and the cost to the accounting utility. By this means, the accounting cost of construction is to be preserved. Thus, the cost of, say, a generating station after having been recorded in the books of the first utility, would follow the ownership of that station and any different cost to an accounting utility would be ear-marked in a separate account.

The difference between the cost to the accounting utility and the original cost of operating units or systems may represent intangible costs, such as franchises, monopoly value, etc., but in many cases, we have found it is almost impossible to determine the real nature of the difference. In any event, in the reclassification process provided in the system of accounts, the difference between such original cost and the cost to the accounting utility is ear-marked for study by the Commission and final disposition as the facts warrant.

The entire process, as far as the system of accounts is concerned, is merely a reclassification of

(Testimony of Charles W. Smith.)

the amounts recorded in the plant accounts. The cost in the books is regrouped in the interest of obtaining more and better information and this paves the way for more intelligent action. The system of accounts does not require a utility to charge off any amounts appearing in its books, even though such amounts are known to represent pure inflation. All book [486] amounts are simply reclassified into new accounts. Further and specific action is necessary before any amounts can be ordered to be charged off and this action must be by the Commission.

Q. Now, does original cost principle, of which you have spoken, apply to all acquired property?

A. I have stated the original cost principle relates to the acquisition of operating units or systems. The accountants, in this connection, borrowed a principle from the law—deminimum non curat lex—they were not concerned with trifles. They were not concerned with the purchase of individual poles, meters, transformers, etc., for no matters of substance are involved therein. They were concerned, however, with transactions heretofore associated with the commission of grave accounting offenses, namely, the purchase of going concerns or large segments of operating properties. Not knowing, frequently, what the purchase price represented, and desiring to preserve the cost to the original utility for many purposes of regulation, they wrote into the system of accounts, original cost provisions.

(Testimony of Charles W. Smith.)

Q. Does the system of accounts permit a utility to go back over the years and reaccount for its own construction costs?

A. It is my consistent interpretation that the system does not permit a utility to reaccount for its own [487] construction costs. It does, of course, permit the correction of genuine accounting errors, for such errors should always be corrected as soon as discovered under any system of accounts. Most of such errors which have come to my attention should have been corrected a long time before any new system of accounts was prescribed. Many of the errors, however, are being disclosed for the first time because of the analysis work required by the new system of accounts.

Q. Now, where in the system of accounts do we find provisions relative to this matter?

A. The specific provisions in the system of accounts relative to this matter are contained in the electric plant instructions.

Q. What are the summary plant accounts?

A. Electric Plant Instruction 1 shows that the plant accounts are divided into the following summary accounts:

100. Electric Plant.
100.1 Electric Plant in Service.
100.2 Electric Plant Leased to Others.
100.3 Construction Work in Progress.
100.4 Electric Plant Held for Future Use.

(Testimony of Charles W. Smith.)

100.5 Electric Plant Acquisition Adjustments.

100.6 Electric Plant in Process of Reclassification.

107. Electric Plant Adjustments.

Q. Now on what basis are Accounts 100.1 to 100.4, [488] inclusive, to be stated?

A. Electric Plant Instruction 1(C) states that:

"Accounts 100.1 to 100.4, inclusive, are designed to show the original cost of electric plant acquired as operating units or systems by purchase, merger, consolidation, liquidation, or otherwise, and the cost to the utility of all other electric plant recorded in these accounts."

I want to emphasize the phrase "cost to the utility of all other electric plant recorded in these accounts". That merely means that the cost to the utility of its own construction, in accordance with accepted principles of accounting, shall be retained in the accounts under the new system.

A technical distinction is made between original cost, which is restricted to acquisitions, and the company's own construction costs. For all practical purposes, as shown elsewhere in the system of accounts, the accounting cost of a utility's own construction is regarded as original cost. Technically, to repeat, the original cost provisions relate only to acquired properties.

Electric Plant Instruction 1(D) provides:

"Account 100.5 is designed to show the difference between the cost to the utility of electric plant ac-

(Testimony of Charles W. Smith.)

quired as operating units or systems by purchase, merger, consolidation, liquidation, or otherwise, and the original cost of the plant, due consideration being given to any depreciation or [489] amortization recorded by the accounting utility at the date of acquisition."

It is conclusive that amounts can be recorded in Account 100.5 only in connection with the acquisition of operating units or systems. The account is not used in connection with a utility's own construction.

Q. What is Account 100.6?

A. Account 100.6 is designed to include the cost of plant appearing on the books of the utility as of the effective date of the system of accounts. It is a temporary account. After the reclassification process has been completed, Account 100.6 will disappear.

Q. What is the function of Account 107, Electric Plant Account?

A. Account 107 is to be used to record the difference between the amount in the books of a utility and the cost to that utility. Original cost is not involved. The accounting system specifically provides that it shall contain the write-ups in the accounts and this was almost the exclusive purpose of creating the account. Many write-ups have been made in public utility accounts. Such write-ups, in my opinion, offend grievously the principles of ac-

(Testimony of Charles W. Smith.)

counting. The new system of accounts, pursuant to its main theme of requiring a reclassification of plant accounts, provides that write-ups shall be reclassified and included in Account [490] 107. Account 107 will bring the amount of direct inflation to the attention of the Commission. It is the accountant's duty to bring out the facts. It is the Commission's duty to see that proper disposition of the write-ups is made after obtaining the facts. The accounting system itself does not provide for the disposition of inflation—it merely provides, to reiterate, for the ear-marking of the accounts thereof.

Q. I believe, Mr. Smith, that you have testified that the System of Accounts, Exhibit 6 in this proceeding, does not require or permit reaccounting of a utility's own costs, accounting costs?

A. It has been my consistent interpretation of the System of Accounts that the utility's own construction costs should not be disturbed except for genuine accounting errors.

Q. Now, will you explain how you arrive at this conclusion, giving reference in your answer to the System of Accounts, and the provisions thereof?

A. Provisions relating to the original cost relate specifically, as I have indicated, to acquisitions of operating units or systems. It is contrary to the system of accounts to try to apply these original cost provisions to the utility's own construction in

(Testimony of Charles W. Smith.)

such a manner as to increase the amount of recorded cost of construction. This view is firmly established, among other provisions, by Electric Plant Instruction [491] 2. Instruction 2(A) provides that the classification shall be such as to show both the original cost and the cost to the utility of its electric plant. Instruction 2(B) is particularly important. It provides that cost to the utility shall be ascertained by analysis of the utility's records, and then says that:

"* * * In ascertaining the cost it is not intended that any correction need be made for depreciation or amortization applicable to operating units or systems previously acquired, whether or not such depreciation or amortization was recorded in the books of the accounting utility." [492]

I might pause to explain that provision. It merely means that whatever the utility recorded in its books at the time of the transaction shall not be disturbed. In other words, we shall not go back and try to make any corrections, because proper depreciation was not set up in connection with the acquisition at the time of the transaction. In fact, if no depreciation were recorded at all, no correction or adjustment need be made.

"It is likewise not intended that adjustments shall be made to record in electric plant accounts amounts previously charged to operating expenses in accordance with the uniform system of accounts

(Testimony of Charles W. Smith.)

in effect at the time or in accordance with the discretion of management as exercised under such uniform system of accounts." This last sentence means that re-accounting of a company's own construction in the manner proposed by the Northwestern Electric Company should not be permitted. The sentence was inserted, specifically and solely, in my opinion, to prevent re-accounting of this nature.

Electric Plant Instruction 2(C) provides, among other things, that detailed electric plant accounts, that is, Accounts 301 to 390, "shall be stated on the basis of cost to the utility of plant constructed by it and the original cost, estimated if not known, of plant acquired as an operating unit or system." Electric Plant Construc- [493] tion 3(A) also provides that: "All amounts included in the accounts for tangible electric plant consisting of plant acquired as an operating unit or system shall be stated at the original cost incurred by the person who first devoted the property to utility service. All other tangible electric plant shall be included in the accounts at the cost incurred by the utility." It is true that in one or two places in the system of accounts the term "original cost" is used to refer to amounts in the detail plant accounts. This, in fact, is the general practice of accountants who look upon a utility's own construction costs as original cost. In fact, the utility's own construction costs

(Testimony of Charles W. Smith.)

are original costs. Technically, however, these other statements relate back to the specific electric plant instructions where it is clear that the amount of a company's own construction shall not be re-accounted for under any claim that the original cost provisions require re-accounting. These other references do not contain new matters; they relate back to the specific provisions I have enumerated which disapprove of re-accounting.

Q. Then as I understand your testimony, the primary requirement of the system of accounts, so far as plant accounts are concerned, is a better classification of book cost, is that right?

A. That is correct. The system of accounts [494] provides for reclassification of the book figures as of January 1, 1937 and not for a re-accounting of cost. As far as plant accounts are concerned, the main theme of the system is this reclassification. There never was any intention at the time the system of accounts was under compilation, nor has there been any interpretation by me or by the Committee on Statistics and Accounts of the National Association of Railroad and Utilities Commissioners, which would lend any credence to the view that re-accounting for the purpose of increasing the recorded plant costs can be practiced under the new system of accounts. Instead, it is the consistent interpretation that such re-accounting is prohibited.

Q. Now let us turn, Mr. Smith, to the specific adjustments discussed in the Examiners' Report,

(Testimony of Charles W. Smith.)

Exhibit No. 3 in this case. Turning to the specific adjustment recommended in the Staff Report, Exhibit No. 3, please state whether or not you approve of the adjustment indicated with respect to interest during construction, in the total amount of $37,020.26, that amount having been reduced by some $3,000, the testimony of one of the company witnesses here. With respect to the adjustment made or recommended to be made by the staff, will you state your position?

A. The adjustment referred to simply reverses an adjustment made by the company in its reclassification [495] study. I concur in the staff report recommending that reversal although if the interest had been charged at the time of construction no question relative thereto would have been raised. It is customary in public utility accounting to permit interest on construction expenditures to be charged to plant accounts even though direct interest costs cannot always be identified. Thus, our system of accounts allows interest to be charged on the company's own funds used to pay for construction work. This is a departure from the general accounting rule to the effect that actual interest cost must be shown in order to be capitalized. The public utility rule is probably grounded on the fact that public utilities almost always have bonds or debt securities outstanding.

Electric Plant Instruction 2(B) of the Commission's system of accounts indicates that it is not in-

(Testimony of Charles W. Smith.)

tended that overheads, etc., previously charged to operating expenses, shall now be included in plant accounts. Interest is not an operating expense, but, rather, a non-operating expense, and it is not included as an expense in computing rates to be paid by customers. Accordingly I recognize that it may be argued that interest is not within the prohibition of Electric Plant Instruction 2(B) to which I have referred.

On the other hand, the adjustments cover a period from July 1, 1914, to December 31, 1925. The accounting [496] of the time followed pretty well the general principles of accounting rather than the special practices today of public utilities. Even today for income tax purposes, interest is always an expense, and not a part of the cost of the plant.

The accounting practices of the company for the period mentioned must have been known for a great many years. I am reluctant to see adjustments permissible if made at the proper time deferred for such a long period of years. I believe such adjustments should not be made after the accounting has been concurred in by the utility's officers and reflected in the financial statements of the company for a great many years when, as here, a general rule of accounting does not require the adjustment to be made.

Hence, I believe the Commission would be fully justified in refusing to recognize the adjustments claimed by the company because such adjustments

(Testimony of Charles W. Smith.)

are permissive, rather than mandatory, as far as accounting principles are concerned. [497]

Q. It is shown on page 14 of Exhibit No. 3 that the company has attempted to add to the cost of plant in service the amount of $34,216.13, representing computed interest on cash allegedly held for construction purposes for the years from 1914 to 1936. Do you agree with the adjustments made by the company?

A. No, I do not. In fact, there is no justification in my opinion to support the adjustment.

Q. Will you explain the reason for your answer?

A. The rule permitting utilities to capitalize interest on their own funds expended for plants, without showing that interest cost has actually been incurred, stretches the general principle of accounting, far enough in my opinion. The rule permits interest to be charged at a reasonable rate from the time construction expenditures are made until the property represented thereby is available for service. The company would go farther and long after the fact would make a general, theoretical computation designed to segregate its general cash account into that part held for construction purposes and the other part held for all other purposes and charge interest during construction on the former. Such interest, of course, is in addition to the interest charged on actual expenditures during the actual construction period. [498]

I repeat that the claim, in my opinion, possesses no merit. Cash for construction purposes should

(Testimony of Charles W. Smith.)

not be obtained for long periods in advance of the construction. The company's method implies the company should maintain a construction cash balance at all times equaling to the cost of construction. This cash would be replenished as used and, under the principle, interest would go on perpetually on the balances. In practice, cash is not earmarked in this fashion. The cash on hand is general cash available for all purposes. The company's cash, as far as I can ascertain, represented the normal cash working capital requirements. In fact, during a substantial period of time covered by the company's study, its working capital position was very bad. It is permissible to raise cash specifically for a construction project and to charge all interest actually incurred on the cash so raised to construction during the construction period. When this is done, however, interest is not charged on the construction expenditures as made and also on the total cash held for construction purposes, but only the actual interest cost is capitalized and then only for the construction period. In other words, there must be no duplication.

This latter method is different from the method advocated by the company. The company, in fact, would establish a new rule of accounting. To permit this new rule to be practiced would be to permit the pyramiding of interest as a [499] construction cost and would authorize utilities to depart still further from the general accounting rule in respect to interest during construction.

(Testimony of Charles W. Smith.)

A company must keep on hand a certain amount of cash for general corporate purposes including the maintenance of sound credit, even though construction is not in progress. It is wrong, in my opinion, to make a computation of the amount constructively held for plant costs and include interest thereon as a capital charge. I would oppose not only the re-accounting for past transactions of this nature but I would just as definitely and strongly oppose any attempt to charge such interest to plant currently. I believe our Uniform System of Accounts does not permit that kind of accounting.

Q. Now, it is indicated on page 15 of Exhibit No. 3, that the company in its reclassification study has sought to make an adjustment whereby computed interest and taxes on materials allegedly held for construction purposes are charged to plant for the years from 1915 to 1935, inclusive. Do you believe that the company's adjustment is proper?

A. No, I concur in the recommendation of the staff report that the company's adjustment be reversed.

Q. Now, will you give the reasons for that answer?

A. First of all, the company's claim in this respect again completely departs from general and public utility ac- [500] counting practices. The company's scheme, therefore, does not have the sanction of good accounting usage. In addition, it is theoretically bad. When a new company is formed

(Testimony of Charles W. Smith.)

and begins construction work, it is quite generally agreed that the company can not have a profit or loss until revenue transactions begin. Consequently, during the construction period, all interest, all taxes, all overheads and all other costs are invariably capitalized as a part of the cost of property or shown as a deferred charge. After the operating stage is reached, however, a segregation of costs applicable to plant and those applicable to operations is absolutely essential. Emphasis then, is laid on operations, the transactions which produce profits. All interest paid during the period of construction, when construction was the sole activity, is capitalizable. In industrial and commercial accounting, after operations begin, only *indentifiable* interest costs are capitalized as a part of the cost of plant. In public utility accounting, as I have pointed out already, this rule is stretched to permit the capitalization of interest on construction expenditures, even though interest payments can not be associated directly therewith. The subject of interest as a cost has received a great deal of consideration by accountants. The question has been discussed primarily in connection with cost accounting. Particularly, it has taken the form as to whether [501] or not interest should be included in inventories. The overwhelming concensus of opinion is that such interest should not be included in the cost of inventories. Perhaps because economists, who look upon interest as a cost (the wages of capital, as they sometimes put

it), influenced the early system of accounts for railroads, interest is permitted to be included on all public utility construction expenditures. This, in my opinion, is as far as the rule should go.

Every public utility needs a certain amount of materials and supplies in the regular course of business. Many of the materials and supplies can be used either for plant additions and betterments or for operations and maintenance. These materials and supplies are looked upon as working capital and interest is not computed thereon. Reasonable working capital, instead, is usually included in the rate base in computing rates. In some cases, certain plant items, even though theoretically in the category of materials and supplies, are actually included in the plant accounts themselves and not in the materials and supplies account. I refer to such things as meters, transformers and large separate parts, such as water-wheels. These items by being included in plant, of course, do not carry interest, for when items are charged to the plant-in-service accounts, interest stops. The company's plan would logically mean the capitalization of [502] interest on materials and spare parts during all the period they are held for possible use as plant items. In the case of large, spare items—large transformers and water-wheels for instance—the interest costs would likely be an enormous proportion of the total cost and would be completely out-of-line with the economic value of interest in the total value of the item. In

(Testimony of Charles W. Smith.)

other words, it is not unusual for a spare part to be held for ten years, and if the nominal rate of interest is 6 per cent, then the total interest cost would be 60 per cent of the spare part. If compound interest were employed, the interest element would be close to one hundred per cent of the original cost of the item.

In rate proceedings, it is customary to include a reasonable amount of material and supplies as working capital. This is as it should be and, of course, interest should never be capitalized on the cost of materials and supplies included in the working capital allowance.

The effect of capitalizing interest on the cost of materials and supplies is: (1) to divert a non-operating expense charge (interest) to a future operating expense (depreciation), or (2) if interest expense is not actually incurred in carrying materials and supplies, then to charge future operations by crediting, directly or indirectly, present income. In any event, the adjustment proposed by [503] the company is bad accounting and should not, in my opinion be permitted.

Q. Will you explain your views, Mr. Smith, on the items of computed taxes on materials and supplies which the company claims should now be added to the cost of electric plant?

A. Taxes, of course, constitute one of the most familiar and one of the largest items of expense. Taxes incurred during a period when the company

(Testimony of Charles W. Smith.)

is engaged solely in construction are capitalized. Payroll taxes on construction labor and ad valorem taxes included in the price of things purchased for construction purposes, are capitalizable. This is in accordance with the system of accounts. It would be offending correct principles of accounting to compute a proportion of the general taxes as being appliable to materials and supplies and then to make another computation showing the amounts of the latter proration deemed to be a proper plant cost. My reasoning in this connection follows very closely the reasoning in regard to interest on materials and supplies, concerning which I have just testified. I believe it wholly wrong after charging taxes to expense under sound accounting principles to attempt to re-account for them by charges to plant and then to charge the item to expense again under the guise of depreciation.

As far as materials and supplies are concerned, cer- [504] tain items should be included in plant and the company permitted to earn thereon. Other items properly belong in working capital on which the company should be permitted to earn a return. Excessive materials and supplies should be carried at the company's own expense. Carrying charges such as interest and taxes on such items should not in my opinion be capitalized. [505]

Q. Were you here at the conclusion of Mr. Bell's testimony on cross examination? A. I was.

Q. Did you hear his testimony with respect to

(Testimony of Charles W. Smith.)

these items, the capitalization of interest on cash, working capital, and interest on interest and taxes on materials and supplies? A. I did.

Q. Now, it is my understanding of his testimony at the conclusion of his cross examination, and of your testimony, that his conclusions and your conclusions with respect to those matters are the same.

Mr. Priest: Just a minute, Mr. Examiner. I suggest the record will speak for itself on that particular subject.

Mr. Slaff: I think it speaks for itself, speaks pretty loudly on that subject.

Mr. Priest: I am not so sure that I concur, Mr. Slaff. Go ahead.

Mr. Slaff: That is where we have a difference of opinion, perhaps.

The Trial Examiner: I think that is true. Perhaps Mr. Smith, if he is to testify on that, should state his understanding of the testimony, Mr. Slaff.

Mr. Slaff: Well, as far as I am concerned, there is no necessity to press that matter any further.

[506]

The Trial Examiner: Very well.

Q. Mr. Smith, it is indicated on page 16 and 17 of Exhibit No. 3 that the company has made a re-accounting of its general administrative expenses in such a manner as to add $827,325.21 to its plant accounts." This amount has been revised down by Exhibit 11 to $460,577.00, and that re-accounting covered originally the period 1924 to 1926, and now as

(Testimony of Charles W. Smith.)

revised by Exhibit 11 covers the years 1926 to 1936, inclusive. That is correct, is it not?

A. That is my understanding.

Q. Now, you have already indicated generally that you believe that such items should not be re-accounted for by the company. Will you at this time state your conclusions and your reasons in connection with this specific item?

A. The adjustment claimed by the company represents particularly bad accounting, in my opinion. The accounting in the past was deliberate. No error was made but, rather, a choice was exercised. If this choice can be vitiated at any time and re-accounting practiced, then the income statements of utilities will have little or no meaning because they will be subject to constant revision. Accounting, under the circumstances, would be of little assistance to regulatory commissions and there would be nothing to take [507] its place; hence, regulation would have to struggle along under a most severe handicap imposed by those subject to regulation.

The items in question would never be capitalized in the manner indicated by commercial and industrial concerns and, in fact, today a great many utilities do not capitalize such items. The system of accounts prescribed for steam railroads by the Interstate Commerce Commission does not permit the capitalization of such items in the manner set forth by the company, that is to say, it does not permit allocations and prorations of general adminis-

(Testimony of Charles W. Smith.)

trative expenses. This conforms, in my opinion, to general accounting principles and practices. I recognize, of course, there are many methods of allocating and prorating overhead expenses, including therein general administrative expenses. The method advocated by the company, however, is not, in my opinion, an acceptable method even for current accounting, much less for the purpose of re-accounting of transactions extending over a long period of years in the past. It makes the amount of expenses in the income statement fluctuate with the volume of construction; hence, profits artificially fluctuate with the volume of construction whereas they should fluctuate with the volume and profitableness of revenue transactions. I recently made a test of one case and found that if the method described had been used in one or more years, over 80 per cent of such [508] general administrative expenses would have been charged to plant, whereas in other years the amount would have been a great deal less, reaching a low of about 30 per cent. Obviously such wide fluctuations in administrative expenses allocated to the income statement are wholly unjustified. Such general administrative expenses run pretty much the same whether or not construction is in progress and if any cost is incurred for construction it is an incremental cost and that amount only should be capitalized. I believe, in other words, the method advocated by the company is an arbitrary short-cut which I thoroughly disapprove. The method could yield satisfactory results only by accident.

(Testimony of Charles W. Smith.)

A. I am sure the adjustments do not represent the correction of accounting errors. I have made many accounting investigations and I have been fully informed of the different practices of treating general administrative expenses. I have never made an adjustment such as that made by the company on the theory that the failure to [509] charge general administrative expenses to plant constituted an accounting error.

It was with specific reference to such adjustments that Electric Plant Instruction 2(B) relating to the prohibition of including in plant accounts amounts previously charged to expense was included in the Uniform System of Accounts. The net effect of the adjustment would be to add to plant accounts approximately $465,000 which has previously been charged to expense, to charge this amount to expense again under the category of depreciation with great probability that after having recovered the amount in rates the company would recover them again and also would be allowed a return thereon in the interim thereon. This is bad accounting as well as bad regulation, in my opinion.

Q. Now Mr. Smith it was shown, beginning on page 17 of Exhibit No. 3, that $3,500,000 of an original amount of $10,000,000 of common stock, which was issued in 1911 and 1912 and charged to plant account, still remains in plant account and it is indicated that in the reclassification study the company included the $3,500,000 in Account 301, Organiza-

(Testimony of Charles W. Smith.)

tion. What is your opinion with respect to the proper classification of the amount in question?

A. From examinations made by members of my staff, I am of the opinion that the stock in question was issued [510] without value being received. Accordingly, the amount charged to plant upon the issuance of the capital stock represented a write-up or inflation in the plant accounts. This means that the balance of $3,500,000 now in the plant accounts should be charged to Account 107, Electric Plant Adjustments, in the reclassification process. The latter account provides specifically for write-ups of electric plant account.

Q. Now, paragraph "B" or Account 107, Electric Plant Adjustments, provides: "The amounts included in this account shall be classified in such a manner as to show the nature of each amount included herein and shall be disposed of as the Commission may approve or direct." If the amount is recorded in Account 107, pursuant to your recommendation, what disposition of the amount would you recommend?

A. As far as accounting principles are concerned, the amount, representing a write-up, should be removed from the books of the company. I believe that the Commission would be fully justified from the standpoint of accounting principles in ordering the amount written off or disposed of at once. A policy and not an accounting principle may call for spreading the amount over a reasonable period of years in

(Testimony of Charles W. Smith.)

the future. It is my opinion that if the Commission as a policy matter determines the amount should be [511] amortized over a future period, such period should not be more than ten years, five years being a much more desirable period. In other words, the amount does not belong in the books of account at all, hence the period of amortization, if amortization is approved, should be as short as possible.

[512]

EXHIBIT NO. 22

A. Intangible Capital

No. 1. Organization.

Charge to this account all fees paid to governments for the privilege of incorporation and all fees and other expenditures incident to organizing the electric utility. This includes the cost of preparing and distributing prospectuses, cost of soliciting subscriptions for securities, cash fees paid to promoters, and the cost of their services in organizing the enterprise, attorneys fees, cost of preparing and issuing certificates of stock, and cost of procuring certificates of convenience and necessity, and other similar expenses.

Expenses incident to an increase of the capital stock, and the negotiation and sale of stock thereunder, and expenses of preparing and filing certificates of amendment to the articles of incorporation, shall be charged to this account. Discount on bonds or capital stock shall not be charged to this ac-

(Testimony of Charles W. Smith.)

count, but shall be charged to the account Discount on Securities.

No. 2. Franchises.

Charge to this account the actual amount paid to the State, or to a political subdivison thereof, in consideration for any franchise deemed necessary to the conduct of the electric utility service. Expenses in procuring franchises covering additional territory, to be operated as a part of the existing system, may be charged to this account. If any such franchise is acquired by purchase, the charge to this account, in respect thereof, shall not exceed the amount so actually paid therefor by the electric utility to its assignors. If any franchise has a life of not more than one year after the day when it is placed in service, or in effect, it shall not be charged to this account, but to Operating Expense Account 101—Miscellaneous General Expense.

No. 3. Water Rights.

Charge to this account the cost of all water rights having a life of more than one year from the day when they are placed in service in the operations of the utility.

Such rights include the right to take water, and also the rights of flowage and submersion. Mere licenses revocable at the will of the grantor or upon notice of one year or less should not be charged to this account; but to Operating Expense Account 101.—Miscellaneous General Expense.

(Testimony of Charles W. Smith.)

No. 4. Other Intangible Capital.

Charge to this account the cost of all other intangible property not included in the foregoing accounts, including patent rights, royalties and licenses having a life of more than one year.

CERTIFICATE.

State of Washington,
County of Thurston. ss.

I hereby certify that the foregoing and attached document is a full, true and correct copy of original Accounts Reflecting Intangible Capital as covered by the Uniform System of Accounts for Electric Light and Power Companies effective January 1, 1913 as prescribed by The Public Service Commission of Washington, its Cause No. 924, entitled: "In the Matter of the Adoption of Uniform Accounting Systems and Classification of Revenue Accounts for Electric Light and Power Companies",
now on file in the office of the Department of Public Service of Washington at Olympia.

In Witness Whereof, I have hereunto set my hand and affixed the seal of the Department of Public Service of Washington, this 24th day of March, 1941.

[Seal] A. E. ROTCHFORD
Secretary of the Department of Public Service of Washington.

(Testimony of Charles W. Smith.)

[Printer's Note: Exhibit No. 29 is set forth in Volume III.]

CHARLES W. SMITH,

produced as a witness on behalf of Petitioner, being recalled, further testified as follows:

Cross Examination.

By Mr. Priest: [540]

Q. May I direct your attention first to paragraph of the electric plant instruction 15, which appears, I think, on page 52 of the Commission's System of Accounts, which has been received in this proceeding as Exhibit No. 6. That paragraph "A" reads as follows: "If the utility is engaged in more than one utility service, such as electric, gas, and street railway, and any of its utility plant is used in common for several utility ser- [541] vices or for other purposes to such an extent and in such manner that it is impracticable to segregate it by utility services currently in the accounts, such property may but only with the approval of the Commission, be designated and classified as "Common Utility Plant." Now in the case of the utility company having electric service and also what it designates as more or less by-product steam heating service, does paragraph 15-A require such utility to designate any such jointly used property as "common utility plant"?

A. Not in the absence of Commission action.

(Testimony of Charles W. Smith.)

Q. Then so far as the classification of accounts itself is concerned, such classification would be entirely optional, so far as the common utility plant is concerned? [542]

A. No, I can't go that far with you, Mr. Priest. A utility shall not classify any property as common unless it gets the approval of the Commission. My interpretation would be that the Commission could still order a classification as common property.

The important thing in this connection is that the Commission know what is being classified as common property. There are many reason for that. The big reason is that in some instances in the past certain companies classified practically all properties as common, and it presented a pretty difficult regulatory problem.

A company cannot, under this system of accounts, classify its property as common unless it gets permission from the Commission.

Q. I assume, then, that the Commission could order a classification as common?

There is nothing in the classification of accounts, however, which requires such a utility so to classify its plant account? A. That is true.

Q. I would like to refer briefly to your convictions on the subject of original cost as expressed in your direct testimony. You would say, would you not, that the significance of so-called original cost, from the point of view of rate-making, from the point of view of the issuance of [543] securities,

(Testimony of Charles W. Smith.)

and from the point of view of the application of regulation to public utilities has greatly increased in recent years, would you not?

A. Yes, it has greatly increased since the systems of accounts such as we are considering here were adopted.

Q. You know, do you not,—I am sure you do, Mr. Smith,—that many public utility companies, including the Northwestern Electric Company, have been proceeding over a period of many years on the theory that at least so far as their rate bases are concerned, that they are entitled to a reasonable return upon the fair value of their property?

A. I think that is true.

Q. But, in spite of that fact, and in spite of the greatly-increased significance attached to original cost, you do not think that under such a system of accounts as that before us here in Exhibit No. 6, an accounting utility should be permitted to reclassify its property so as to include therein all legitimate items of original cost whenever incurred and whatever the original accounting treatment of those items may have been?

A. Mr. Priest, I have difficulty with your word "legitimate".

Perhaps I can explain and give an answer.

Q. I wish you would.

A. Rather than give a yes or no answer. [544]

Q. I wish you would, Mr. Smith.

(Testimony of Charles W. Smith.)

A. First of all, your fair return on fair value concept involves operating income as well as a rate base. Operating income involves revenues and expenses. Those items which were determined as expenses in these proceedings, in my opinion, should ever remain as expenses.

Now, as to the question of getting the actual, legitimate original cost of property, my answer is that you should get it. But I probably disagree with you as to the process and as to what we mean by the term.

"Original cost" does not mean the original cost of every individual item of property. I pointed out yesterday that you must always consider the two phases of accounting, the balance sheet and the income statement.

Now, in our system of accounts certain items of property are still classified as maintenance. I will give you an illustration. A pole stub is a maintenance expenditure. A guy wire, guying a pole, is a maintenance expenditure. They ought to be charged to expense. They should remain there. They should never be included in "original cost." So as soon as you say that original cost ought to contemplate all property, automatically you are in a conflict with your accounting for the income statement. "Original cost" necessarily means "original cost", according to accounting standards. [545]

Q. I am sure that that is your point of view, Mr. Smith. A. Yes, sir.

(Testimony of Charles W. Smith.)

Q. But should not a company which, as I say, has carried on its operations in the light of a fair value concept and which only within recent years is confronted with the increased significance of original cost,—should not such a company in a present-day classification of its accounts at least be permitted to include in original cost all the items of such cost which are contemplated in and provided for by the Federal Power Commission's present system of accounts, as it will be applied to such accounting utility companies from this time forward?

A. With the exception of the application of the list of units of property, I think you are right. And I will come back to "units of property" in just a second.

But I think the elements of cost under the old system of accounts are just the same as they are under the new system of accounts. There isn't any difference. Original cost under the new system of accounts is just the same as under the old. The elements are the same and the costs are the same. The only difference occurs in connection with what we know as a list of units of property, and that list is not involved in this present proceeding.

I would like to explain it, however, just for the purpose [546] of the record. There has always been, from the very inception of accounting, great difficulty in determining what are maintenance expenditures, those expenditures which are designed to keep a plant in good operating condition, and those ex-

(Testimony of Charles W. Smith.)

penditures which add something to a plant. That has been a difficult question for centuries.

Now when the new system of accounts was prescribed, we wanted more uniformity in plant accounting. We knew that some companies, when they replaced poles, charged the cost of the new poles to expense, unless as many as ten in a row were replaced. We knew other companies used a single pole as a replacement unit.

Accordingly we got together with representatives of the industry and we prepared a list of units of property. That list shows what items must go into plant account. It is effective for the future only and it is subject to change, and the utilities have the full right to subdivide that list at will.

I say, it would be absolutely wrong to try to make any such list of retirement units retroactive.

But I don't think that is involved here because I heard testimony to the effect that the Northwestern Company has considered each pole a unit of property for a great many years. Glad to hear that. That is rather advanced accounting. [547]

Q. Then does the reclassification of plant account, which your uniform system of accounts contemplates, require a restatement of actual cost?

A. A reclassification only.

Q. Well, is it a sort of rearrangement or resorting into new compartments of accounts now appearing on the books of the accounting company?

(Testimony of Charles W. Smith.)

A. That is the primary purpose of the system of accounts.

Q. Well, is it only that, Mr. Smith?

A. It paves the way for much more. But that is the primary purpose of the system, as far as the original cost of plant accounts are concerned; they are designed to give more information by providing a better classification; where costs can be computed in accordance with accepted standards; there is no attempt to disturb them.

Q. Can you distinguish for me between a reclassification and a reaccounting from the point of view of the purposes of your new system of accounts?

A. Yes. Reclassification simply means that you take the amount of dollars appearing in the company's books and spread them to the new accounts. Reaccounting means that you go back and try to recompute costs all the way through—get new figures to deal with.

Q. Then will you distinguish between a reaccounting [548] and the correction of an accounting error that the accounting company is entitled to correct?

A. A reaccounting is going back and applying the present judgment of some person doing the work as to all past transactions in contradistinction to the judgment applied by a responsible officer at the time the transactions were incurred, which judg-

(Testimony of Charles W. Smith.)

ment was in accordance with the practices of the time.

Accounting errors represent those things which were wrong at the time, which were not sanctioned at the time, were improper accounting. The most notorious accounting errors we have run across so far have been the failure to record the retirements of property in the books of account. That is being disclosed by the analysis work made necessary by the system of accounting.

Q. And that is an accounting error required to be corrected?

A. That is an accounting error, and an accounting error under any system of accounts.

Q. But generally, Mr. Smith, can you say whether or not a judgment factor has to be applied in determining whether a particular matter is a correction of an accounting error or to that extent a reaccounting?

A. Well, judgment has to be applied to a certain extent, of course. But generally speaking, there isn't [549] a grave difficulty, much difficulty, in determining accounting errors. Accounting errors are those things which were not sanctioned under the system of accounts in effect at the time, or under good accounting practices.

Q. But when you say "were not sanctioned", of course that obviously implies the application of a judgment factor?

(Testimony of Charles W. Smith.)

A. It implies a knowledge of what was being done at the time, a knowledge of practices. I think all trained accountants have that knowledge. In other words, books containing entries that public accountants would not certify to if they knew about it. No public accountant would certify to a plant account if he knew the plant account contained dollars representing property no longer in existence. That would be pure accounting error.

On the other hand, they would certify, and did certify in the case of Northwestern Electric Company, to various allocations of overhead expenses.

Q. In the earlier years of the enterprise?

A. That is right. Right along, and in later years too, as to allocation of overhead. And, certainly, I would go along with that basis.

We are not today, Mr. Priest, in our audits, attempting to make any adjustments for overheads which we think have been distributed in accordance with methods regularly approved by accountants, even though these methods [550] vary widely. We could go into every case and make an adjustment of overheads if we wanted to do so. Any accountant could do that. But we are not doing it because we recognize considerable latitude must be allowed under the old system of accounts, as well as under the new.

Q. You don't think that you and Mr. Bell, for example, or you and Mr. Platt, for example, might

(Testimony of Charles W. Smith.)

differ as to what constituted an accounting error and what constituted a matter of reaccounting?

A. I think Mr. Bell and I would agree pretty well. I am not so sure about Mr. Platt, although I think if Mr. Platt and I were locked up in a room together we wouldn't have much difficulty in agreeing. Formal proceedings sometimes lend a little different atmosphere to things.

Q. The matter of service fees charged Northwestern Electric Company by its service organization was gone into yesterday. I understand, and counsel will correct me if I am wrong, that those fees are not in issue in this proceeding?

Mr. Slaff: That is my understanding.

By Mr. Priest:

Q. I wonder, Mr. Smith, if you can tell us whether the restatement of such service fees, pursuant to what may be later investigation by the staff of the Commission, would be a reaccounting?

[551]

A. It would depend entirely upon whether or not any profit of consequence was derived by the Company rendering the services.

There is a principle of accounting which has been in effect ever since I have known anything about accounting, that there shall not be intra-company profits reflected in the financial statements. It would be wrong to show intra-company profits, I think, in any statement. They ought to be eliminated. It

(Testimony of Charles W. Smith.)

has been the practice to eliminate intra-company profits in consolidated balance sheets.

Now, if intra-company profits are recorded in the plant accounts, in any substantial amount, they should be adjusted. I think that would be sound accounting and would not be a reaccounting. [552]

Q. Would any judgment factor be involved in determining the amount so to be corrected, Mr. Smith?

A. Yes, a judgment factor would be involved and a most comprehensive investigation would be involved. As you and I both know, Mr. Priest, from our investigation of the Bond and Share charges in the Wallenpaupack case, it is a tremendous undertaking, and that is why we are not going into it at this time.

Q. To the effect that a judgment factor was involved in a case of that kind, would that be a reaccounting or the correction of an accounting error?

A. It would be the correction of an accounting error.

Q. In any event?

A. Yes sir. To get back to the basic facts, the judgment, I think, would not be related to the major items. The judgment factor would come in primarily as to what are the overheads. If the company has used a definite scheme of accounting in determining the cost of services, if it has followed a consistent scheme of allocating overhead, perhaps no judgment would be involved in the proceedings

(Testimony of Charles W. Smith.)

to establish the cost. But where no scheme of computing overheads has been followed, and you simply have the undistributed amount in the books, then when you make those [553] distributions from the accounts more than likely there would be a controversy with any two accountants who would be charged with the duty of making the allocation.

Q. Mr. Smith, how would such a re-statement be required to be recorded?

A. Why, excessive overheads or the excessive cost of services, the amount representing the profits to the suppliers, in other words, hould be included in Account 107.

Q. Mr. Smith, is a re-statement of capital stock expense, which, as I understand it, presently appears in the accounts of many of the accounting utilities in organization expense,—is the re-statement of such capital stock expense a re-accounting?

A. No sir; a reclassification.

Q. As I understand it, however, such a reclassification does require the accounting utility to transfer such capital stock expense from Electric Plant Account into Account 107, and thence—correct me if I am wrong—and thence to Account 151, Capital Stock Expense, which is not in the Electric Plant Account; is that right?

A. That is correct. In other words, the item ultimately goes to an account which contains nothing but capital stock expense, but the re-classification is not charged off in any way, and there is

(Testimony of Charles W. Smith.)

nothing in Account [554] 151 which would require charging off the amount. The amount still stays on the books, the same amount if it is correct. It simply is taken out of Plant Account, because the item is not Electric Plant, and it goes over into another Account, that is called Expense on Stock, and that is just what the item is.

Q. And, pro-tanto, of course, the Electric Plant Account is reduced?

A. That is correct. I might say even there, Mr. Priest, that under the old system of accounts we have always had great difficulty in finding out just exactly what went into organization in connection with the flotation and the issuance of capital stock. We have had a good many difficulties there. The new system provides for ear-marking those items, and it gives much more information in regard to them.

Q. Now, just what kind of an account is Account 151?

A. 151 is—I think the title explains it very well, "Capital Stock Discount and Expense." It is a balance sheet account.

Q. I understand that, as a matter of form, but what is the account as a matter of substance?

A. I don't know as I get your point. It is under a general title of "Capital Stock Discount and Expense." It is a balance sheet account, and it is on the asset [555] side, and it stays on the asset side until you voluntarily charge it off. There is no requirement that it be charged off, as long as the stock is outstanding.

(Testimony of Charles W. Smith.)

Q. Of course, to leave it on that side does not make it an asset, does it, Mr. Smith?

A. Well, all items appearing on the debit side of the balance sheet are not assets, of course. Our designation is "Assets and Other Debits", but it is a balance sheet item, and the important thing is that it is not required to be charged off to surplus to reduce your surplus; it does not change your net worth. It does not change your proprietorship; it does not change your surplus. It stays on the asset side until the stock is retired.

Q. The only change is the company's Electric Plant Account which may be used in a rate base as rate proceeding initiated by this Commission.

A. It does not eliminate the item from consideration in a rate base, by any means. My personal view is that the item is entitled to more consideration in the rate of return, but there is no reason why if the Commission wants to use this in the rate base he cannot do so. It is plainly before the Commission. It is not hidden away. As a matter of fact, it is emphasized somewhat.

Q. Now as to the matter of Interest During Construction. Is a re-statement of omitted interest during construction [556] a re-classification or re-accounting or a correction of an accounting error?

A. I think it is a re-accounting. You mean under the circumstances we have in this case?

Q. No; I mean generally.

(Testimony of Charles W. Smith.)

A. You are speaking generally?

Q. Yes.

A. Well, now we have to qualify it somewhat. Bona fide interest costs, actual interest costs, should be charged to Plant Account, and if this actual identifiable interest cost were eliminated, then you could put this in under your correction of accounting errors. I could give a little illustration: You build a hydro plant, and you use bonds to get the money to build that plant, directly incur a debt obligation, certainly the interest on those bonds in the construction period ought to be charged to the plant. That is sound accounting.

Q. Now, Mr. Smith, there is nothing in paragraph 2(B) of the Electric Plant Instruction in your system of accounting that prohibits the restatement of interest during construction not charged to construction in prior years; is that right? A. That is correct.

Q. And therefore the question of whether a particular item of interest during construction should or [557] should not be re-stated in an accounting company's reclassification of accounts would involve, again, the application of a judgment factor?

A. It involves primarily a policy matter, I would say. Mr. Priest, many companies today are not capitalizing all the interest which they could capitalize, and they are doing it deliberately. A

(Testimony of Charles W. Smith.)

great many utilities say they don't believe in this business of capitalizing interest up to the hilt. Your company did not believe in it, and many others do not. Every utility of which I have knowledge, has a rule that certain expenditures under a certain amount shall not bear interest and certain construction which is in progress a short time shall not bear interest. I know many public utility men who think that our Commission's System of Accounts rule is wrong because it is too liberal in this respect. I think the income tax rule is much better. We have gone awfully far in permitting interest to be capitalized. So I think that when you deliberately make up your minds as to what interest will be capitalized, I certainly think that you ought to stick by it. There is no difference with respect to interest under the old system of accounts and under the new.

Q. But the question as to whether a particular item of interest during construction should or should not be re-stated in an accounting company's re-classification under your [558] system of accounts is one as to which competent accountants might well differ, is it not?

A. As to whether it shall be re-stated?

Q. Yes sir.

A. I don't think it is so much an accounting principle. In your accounting today, you folks are not charging all the interest you may charge, and five years from now, after this proceeding, and

(Testimony of Charles W. Smith.)

after this full discussion, you might come along and claim more interest, and I would say it ought to be denied to you. You ought to make up your mind as to what you want, and stick by it, because if you don't you are going to bring chaos to prevail in accounting methods.

Q. Referring to sub-paragraph 12 of Paragraph 5 of the Electric Plant Instructions and to Paragrap 6(A) of the Electric Plant Instructions contained in the Commission's System of Accounts, do you agree that by reason of the provisions of these two paragraphs, at least a portion of General and Administrative Expenses may be charged to Construction Costs? A. It may be, yes, indeed.

Mr. Slaff: That is currently, I take it, you mean?

Mr. Priest: Well, I will develop that later.

Mr. Slaff: Go ahead. Yes.

Q. It may be, with entire propriety? [559]

A. Yes, indeed.

Q. Well, can you tell me whether or not the accounting companies are, by reason of these provisions, actually directed to charge to construction costs the applicable proportion of such general and administrative expenses?

A. Your word "applicable" leads me to say that they do not have to charge any administrative expenses to construction. That is my determination and my interpretation. That is the practice of many utilities, under this system of accounts. In other

(Testimony of Charles W. Smith.)

words, we have another rule in the system of accounts that says, "Where distributions are made, they must be equitable."

Q. That is right, Mr. Smith, and that I think is the language, to be fair with you, that is the language of Section 6(A), which says that these overhead costs—of course you are more familiar with it than I am—provides that all such overhead costs shall be charged to construction, to the end that each job or unit shall bear its equitable proportion of such costs. Is that not a direction from the commission?

A. No, I don't think it is. And I have officially stated that in my opinion Administrative Expenses do not have to be capitalized. The real purpose of that paragraph is expressed in the concluding parts thereof. Let [560] me explain that under the old system of accounting, many overhead items were never distributed to units of property, but the overheads were carried in separate accounts, and when retirements were made the overheads were not retired. We now provide that all these overheads must get down to Work Order Units, to the end that where retirements are made all overheads come out. And the main purpose of that particular paragraph is to be sure that the old practice of carrying overhead in separate overhead accounts no longer prevails. We have many many cases where retirements are made without the inclusion of any overheads, because the overheads were in separate accounts.

(Testimony of Charles W. Smith.)

This paragraph is intended to put an end to that practice.

Q. I understand that. Now, referring to paragraph 11, appearing on page 11 of the Uniform System of Accounts, under Distribution of Pay and Expenses of Employees, this paragraph says, "The charges to electric plant, operating expense, and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction and operations, shall be based upon the actual time engaged in the respective classes of work or, in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period." You don't think that [561] requires the accounting company to attempt to allocate an equitable proportion of General and Administrative Overhead to construction costs? A. I do not, sir.

Q. Now, Mr. Smith, let us go back for a moment into the earlier years of the industry. As you well know, many of the presently existing substantial public utilities, subject to the jurisdiction of this Commission, were formed as the result of the merger or consolidation of a number of smaller units or systems, many of which had inadequate and eccentric and uncertain and incomplete accounting records; is that right?

A. No, I don't think that is right. You are in a field now which is a hobby of mine, going into old accounting records. I have found old accounting

(Testimony of Charles W. Smith.)

records far better and far more informative than many of the accounting records of today. Accounting is a very old science, Mr. Priest; it goes back a great many years. The balance sheet of the B & O Railroad of 1835 is a very informative balance sheet. The balance sheet of the Washington Gas Company of 1865 is most informative; the balance sheet and the accounting systems of the Georgia Banking & Railroad Company before the Civil War, which shows in its assets slaves, was a far more informative financial statement than you [562] will get from most utilities, today. In isolated cases you had the things which you have mentioned, but if you are going to say that was a general rule, I will have to disagree.

Q. In many instances it was true, however, was it not?

A. Well, I have found instances where it was true, but I have found more instances where it was not true. A person who has the patience to search out old records and see just what has been done will be more than amazed at the results which were accomplished. Most of the things are not nearly as new as some of us think they are.

Q. Such concepts as interest during construction?

A. Interest during construction I found capitalized the books, many, oh, many years ago.

Q. You found general overhead, administrative

(Testimony of Charles W. Smith.)

and general expense capitalized and charged to construction costs?

A. During a pure construction period with revenue transactions not involved, those items were charged to capital. In most cases those items were not charged to capital, after operations began. Just the same as they are not charged today in commercial and industrial accounting. And it is the overwhelming concensus of opinion that they should not be charged in those instances, except the incre- [563] mental costs. The ICC system of accounts, as I mentoned yesterday, says you cannot allocate those charges to construction.

Q. But the concensus of opinion with respect to electric utility accounting is that the equitable proportion of such overhead charges is properly allocable to construction costs; is that right?

A. Or at least may be charged to construction. I say that because a good many utilities, such as one I looked at the day before coming out here, the Potomac Electric Power Company, do not charge those items to construction today. And I think they are right in not doing it. But they are doing it deliberately. Now, if they attempt to claim it in the future, I think they will be absolutely wrong.

Q. In the less industrialized, the less populous sections of the country, would you say that early accounting records were complete and adequate in all respects?

(Testimony of Charles W. Smith.)

A. Well, you cannot generalize that way. I think one of the finest sets of books I ever saw in my life was of a company, one of the first ten licensees under the Edison patents, in Cumberland, Maryland, where from the very inception of the company, stores accounts were kept, for instance, and reports were made which were the precursor of our annual reports. [564] So, from my own experience, Mr. Priest, I cannot say that that statement is correct.

Q. I am referring to the adequacy and completeness, the non-eccentric character of the accounts of companies, say, south of the Mason-Dixon line and west of the Mississippi.

A. Well, when you get west of the Mississippi you are getting into new territory for me. I can go this far with you: Back for many many years, as has been shown by many writers on the history of accounting, particularly a recent writer, I think his name is Peragallo, even a couple of centuries ago, you had good accounting records. But I don't think you had as many good accountants, able accountants; in other words, the science of accounting was developed and had accountants that knew exactly what ought to be done, but perhaps those accountants did not cover a very wide area.

Q. I am afraid in the earlier years, Mr. Smith, we didn't have teachers of accounting as competent as you are.

A. I am sure you didn't have teachers of accounting in the early years, except where an indi-

(Testimony of Charles W. Smith.)

vidual hired someone to instruct him in the science.

Q. Now, Mr. Smith, say 25 years ago, or, rather, 25 years before an accounting company was required to present [565] to the Federal Power Commission the re-classification of its Electric Plant Account, an item was charged to construction costs improperly—let's say that this particular company had a sub-station; that there was a bank of transformers in that station, and it was discovered that that particular bank of transformers had perhaps been charged to operating expenses. And let us assume further that that particular disclosure was not made until the re-classification was about to be effected, would you be reluctant to see a correcting adjustment made, simply because it had been deferred over a long period of years?

A. No, I would not. I cannot help but remark that a transformer that old should have been retired long ago, and secondly I have never seen an item of that nature charged to expense in the early days of the industry. They could not charge it to expense, Mr. Priest; they did not have the revenues.

Q. But you do know that there have been cases where actual labor was not charged to construction? It was charged rather to operating expenses.

A. You mean the electric industry?

Q. Yes.

A. I have never run into it in any substantial amount. Where I have run into it it has involved combination of maintenance and construction, and where [566] the entire amount was charged to the

(Testimony of Charles W. Smith.)

maintenance job. But it was not substantial. I have never seen any substantial amount charged to expense. And I will say to you, Mr. Priest, I have analyzed hundreds of maintenance accountants and operating accounts, covering a long period in the past, to find out just what could have been charged to those items. In the early days electric industry was not profitable, it did not make huge returns, and you will find that those expenses are not overstated. At least that is my experience. The accounting in the past has not been nearly as bad as a good many persons allege, for electric utilities, especially.

Q. Of course there have been cases, but particularly involving the smaller utilities, where when a line extension had to be erected, the manager and the bookkeeper and the chief clerk and other similar employees got together over a week-end and put the line up; isn't that right?

A. You may have something of that nature, but it is not of any consequential amount.

Q. But as to items of that character, where proper components of construction costs were not actually charged to construction, any such items should be corrected for the purposes of the present classification; is that right?

A. Items which you have mentioned would constitute [567] accounting errors, which ought to be corrected. They did not involve a question of

(Testimony of Charles W. Smith.)

choice; items of property like your transformers, for instance, belonged in the Plant Accounts, and should be there.

Q. And the same thing is true of construction labor, for example?

A. Yes, I think so, construction labor, if you confine it to the electric industry.

Q. I am so doing.

A. I have to be careful there, because if you get into another industry, such as the natural gas, I would have to change my statement, because in the natural gas industry it has been an accepted principle of accounting for years and years and years to charge those items to expense, you see. In other words, the cost of drilling wells has been charged to expense by, I should say, most of the oil companies and most of the gas companies for years, and it is permissible under the Income Tax Regulations to treat that as an expense. And in the extractive industry you have a little different situation. I just want to be careful to qualify my answer so that in another proceeding it might not be picked up by someone and say that I have——

Q. I am confining myself strictly to the electric industry, Mr. Smith. Perhaps we may have a case sometime [568] in the distant future involving the extractive industry.

Now, going back, Mr. Smith, to your convictions on the subject of original cost, if a company purchased, let us say, in the 1920's an operating unit

(Testimony of Charles W. Smith.)

gr system constructed in the price valley of 1910 to 1915, in good faith and at arm's length, and spend for it money obtained, or, from institutional and other investors, is the cost represented by enhanced structural value entitled to a permanent place in the purchasing company's Electric Plant Account?

A. Given a permanent place?

Q. Perhaps the word "permanent" is wrong. Of course nothing is permanent. I have been told that not even the pyramids are permanent. Then let us say to a place in the company's Electric Plant Account co-ordinate with other items in Plant Account?

A. I think where the evidence is clear on the point that a company paid for physical properties more than your original cost, and that is a bona fide transaction, not between affiliated companies, that the amount is a bona fide item to go into 100.5, and should be treated as a bona fide cost. I say this to you, Mr. Priest, as I indicated yesterday, that in most cases that have come to our attention we have not been able to satisfy ourselves that the amount was paid for structural value, and in most cases I think intangible [569] value is what was paid for. I say that because you indicated properties were purchased in the 1920's at a cost higher than the original cost.

Q. That is right.

A. Now the inevitable characteristic of physical

(Testimony of Charles W. Smith.)

property is depreciation; one great accountant said that it is on an irresistible march to the junk heap. So I think when you take property ten years old, depreciable property, metals and things of that nature, which are naturally depreciating all the time, and pay more than the original cost for them, that you are going against the tide. I know when you fix 1920 you pick the highest-priced level for a great many years. [570]

Q. Didn't we, in the 20's, didn't we get up on a plateau of prices, which has remained substantially the same since?

A. No. In 1920 you were on a peak. Then it dipped in 1921 and in 1922 and we came back and remained on that plateau to 1929. But in 1920 we were on a peak.

Q. I said in the 1920's, Mr. Smith.

A. That is right.

Q. We had gone from a comparative valley of prices, as I suggested, in 1910 to 1915?

A. No. I can't agree with your facts. It was not a valley of prices. The prices were much lower in 1910 and 1915 than they were in 1920.

The studies of prices which I have made, and I have carried them back as far as 1790, and I have testified to them on several occasions, indicate to me that the 1913 price level,—the times we have exceeded that price level, have been in war times only and periods associated with war. So we cannot say that that was a particular valley.

(Testimony of Charles W. Smith.)

Rather, I would put it this way, that 1920 represented the war peak in prices. And I can conceive that in 1920 you paid for physical properties more than the original cost, the original cost having been incurred right before the war.

But to get back to 1910, I begin to doubt it [571] greatly. I think if you paid more than the original cost you probably have paid for some intangible values.

Q. Then I am sure we are in agreement, that there was a substantial upsurge in prices after the war? A. During and after the war.

Q. And we have gotten onto what may be fairly referred to as a new plateau of prices?

A. A new plateau from 1922 to 1929. Prices started falling in 1929 and reached their low in February or March of 1933. Then there was a climb back up but considerably under 1929, and prices have been in a fluctuating mood in the last three years.

Q. But now they are very substantially higher than they were in 1936 and 1937, and so on; substantially higher than they were in the pre-war years, that is referring to the first war?

A. They are higher than the pre-war period. When you get to 1936 and 1937, why, I wouldn't say they were substantially higher. 1937—I am a little hazy on my recollection of that particular year. I do not think they are substantially higher than in those years.

(Testimony of Charles W. Smith.)

Q. Very much higher in those years than they were in 1933, for example, however?

A. Oh, yes, 1933 was a low point in prices.

Q. Now, let's make some more assumptions. Please [57?] assume with me that company "A" has constructed an operating unit or system, and let us say in order to avoid the criticisms which might be addressed to my assumption, let us say that we are dealing with a hydro-electric development with a large dam and other substantially non-depreciable or at least by no means rapidly depreciable property. And let us assume that this unit of property was constructed at the price levels that prevailed say in 1913, 1914 and 1915, and that in 1925 or 1926 after prices had reached the very mucir higher levels that we have been discussing, the "B" company came along and in an absolutely, arm's-length good-faith transaction purchased from the "A" company the operating unit or system in question.

Now, for the sake of our arithmetic, let's also assume that the actual cost of construction of this unit or system to the "A" company was $100,000, the "A" company having first devoted it to public service. And let's assume that the "B" company, buying it in 1925, paid $150,000 for it.

Now, in the "B" company's reclassification of accounts, pursuant to your system of accounts, what would happen to the $50,000 difference between the original cost and cost to the utility "B" company?

(Testimony of Charles W. Smith.)

A. Why, the $50,000 would be recorded in account 100.5, Electric Plant Acquisition Adjustment.

[573]

Q. And might be recorded there as enhanced structural value?

A. Yes, it would be recorded according to its nature.

Q. And if an appropriate showing were made it would, under your interpretation of the system of accounts, be recorded as enhanced structural value; is that right?

A. The system of accounts simply says it shall be classified according to its nature, and doesn't go any farther.

Q. But it may be recorded, nevertheless, by the "B" company as enhanced structural value? Is that right? A. That is right.

Q. Now, how would you recommend to the Commission that such an item of $50,000 represented by enhanced structural value, in Account 100.5, be disposed of?

A. You are asking me a question on which I have not as yet acted in my capacity for the Commission. You are asking me concerning something on which I have given some thought, but on which I have not acted in any specific case. Consequently, the question is a little premature, as far as my actual experience is concerned. I would say if it was a bona fide transaction, an arm's-length transac-

(Testimony of Charles W. Smith.)

tion, particularly if it were approved by a Commission, that the item in question should be spread over the life of the property. [574]

Q. Should be spread over the life of the property?

A. Yes. That is right. Of course I might do this: I might work out an arrangement with the company whereby we could accelerate the disposition. I would prefer to do that, for the Company's interest, as well as in the interest of the consumers and everyone else.

Q. But normally, such an item would be spread over the life of the property?

A. That is the maximum life which I would recognize. I would probably try to go to the company and say: Can't we deal with this on a round period? It will avoid a lot of complications in accounting, because the $50,000 might have to be associated with parts, and every time a part is retired, a part of the $50,000 would have to come out. Maybe we could agree on a straight amortization of a certain number of years and wipe it out that way.

Q. But, accepting my assumption that we are dealing with property not rapidly depreciable, then that amortization period would be a long one, would it not?

A. It probably would be, depending upon the nature of the—depending upon the properties to which the structural value attaches. If it attaches to the dam, of course it would be a long one. If it attaches to the equipment——

(Testimony of Charles W. Smith.)

Q. (Interrupting) Let's assume—— [575]

A. That is right.

Q. On that assumption, we will say, the amortization period would be a long one, is that right?

A. It would be, yes.

Q. That is the company in that case would either be able to spread the enhanced structural value over the items of property and other accounts in account 100.1, or would be able to amortize the enhanced structural value over a long period of years? A. I believe that you are right.

Q. Now, let's assume that this "B" company that I have just referred to, instead of buying the physical property of the "A" company, bought its common stock in 1925; and let's assume that it paid, say, $60,000 for that common stock, even though the common stock had been issued in an aggregate amount of, let's say, $100,000, represented by a par or stated value for promotional services which were asserted to be worth only $10,000 to the "A" company. I assume that you would consider that the difference between the $10,000 and the $100,000 would be a write-up? A. Yes, sir.

Q. And I assume that you would require this $90,000 to be recorded in account 107, would you not? A. Yes, sir.

Q. And how would you recommend that this $90,000 [576] recorded in Account 107 be disposed of?

(Testimony of Charles W. Smith.)

A. Why, as an accounting principle I would try to get it disposed of at once. Practical considerations come in, which bring in policy matters where I think the Commission might be disposed to amortize the amount.

Q. Over a period of say five years?

A. The shorter the period, the better.

Q. Then, Mr. Smith, we have this situation: The "B" company of my second illustration would have to amortize its adjustment figure either at once, or in the briefest period possible, merely because it bought common stock instead of purchasing the physical property; whereas, the "B" company of my first illustration, where physical property was purchased, would be able to spread the enhanced structural value over other items of property contained in the 100.1 account, or would be able to amortize it over a long period of years? Is that right?

A. Yes, but the purchase of common stock is far different from the purchase of physical properties. When a person buys common stock usually the value of the physical properties is the last thing they will consider.

Q. Let us assume that the "B" company, the second company in this particular instance, did consider the enhanced structural value in this situation,—that is our assumption, isn't it? I am making the same assumptions in [577] the two cases.

(Testimony of Charles W. Smith.)

A. I still think it is a write-up and ought to be charged off.

Q. And you think that the vastly differing result in the two cases is fair and equitable?

A. Yes, I think so.

Q. Now, Mr. Smith, I have got rather a long question to ask you and in fairness to you I think I better hand it to you.

The Trial Examiner: At this time the hearing will stand at recess for five minutes.

(At this point a recess was taken.)

The Trial Examiner: The hearing will be in order.

By Mr. Priest:

Q. Referring still to our "A" and "B" company examples, Mr. Smith, if the "B" company that we have been talking about had had the gift of foresight and had been able to look down the long corridor of the years and had been able to see what it would be likely to be confronted with in the form of the Federal Power Commission's Uniform System of Accounts, it certainly would have elected to purchase the physical property rather than stock, would it not?

A. No, I can't say that. There are many reasons why a company might desire to purchase stock rather than physical properties. [578]

Q. But if the company had been primarily interested in the enhanced structural value inherent in the "A" company's situation—and let's make the

(Testimony of Charles W. Smith.)

assumption that that was its primary interest, then certainly, had it been able to see what it would be later confronted with, it would have bought physical assets rather than common stock, is that right?

A. Well, I hate to make the assumption, myself, that they would have bought physical properties. I will go along with you and say that if they had bought physical properties the situation would have been different, the facts would have been different. But I don't like to make the assumption that the company would have bought physical properties instead of stock in the hypothetical case that you have given me.

Q. Why not, since its only interest was in—since the purpose of the "B" company was to acquire this enhanced structural value, it got it equally well one way by purchasing physical assets as it did in the other way by purchasing common stock, didn't it?

A. Well, the answer is "Why do companies buy stock instead of physical properties?" They buy stock many times—a regular practice. I cannot make the assumption that a company, desiring the enhancement, would necessarily have bought the properties instead of the stock. Maybe it would have. I don't know. I think you are getting me into the realm of theory where I do not know what would happen. [579]

Q. Well, I supose the answer is, Mr. Smith, that had the "B" company had this gift of foresight

(Testimony of Charles W. Smith.)

that we have been talking about, that in order to protect itself, under the Uniform System of Accounts, it would have bought physical property instead of buying stock?

A. Well, it might have; and if it did, the situation would have been different.

Mr. Priest, I think we are assuming in this case that "A" and "B" merged some time after the acquisition of stock in "B"?

Q. No, no, we are not making that assumption.

A. You say they remain two separate and distinct corporations?

Q. Yes, that in the second illustration the "B" company is a holding company.

A. And they have not merged?

Q. No, no.

A. Then the answers I have given you have altogether been wrong because "B" company would include in its investment $150,000 and keep it there. There would be no amortization whatsoever. I think your problem necessarily means a merger to get the answers—to get to the substance of this thing.

Q. Well, assume then,—let's make the assumption on both bases. Let your answers stand on the basis of an assump- [580] tion of the subsequent merger of "A" company and "B" company.

A. That is right.

Q. In that case the write-off will be through 107?

(Testimony of Charles W. Smith.)

A. That is right because there you would have an affiliated company transaction at the time of the merger.

Q. That is right.

A. Now, if there were no merger, "B" would show in its investment account $150,000 and it would stay there,—no charging it off. That is an investment.

Q. And in those circumstances, then, there would be no entry to be recorded either in Account 100.5 or Account 107 in the case of the holding of stock alone? A. That is correct.

Q. There would be no entry to be recorded either in Account 107 or Account 100.5?

A. That is right.

Mr. Priest, right before recess you asked me a question which, upon consideration, I think might have misled me. I would like to explain my answer so that we can get the record straight.

Q. Please do so.

A. You asked me if an amount in 100.5 represented structural value in one case, and then you said in this other case it would be buying the stock of "A".

Q. Right. [581]

A. You said in the first case that amount might be spread over the properties in the plant account?

Q. Yes.

A. I assume you meant amortized over the life

(Testimony of Charles W. Smith.)

of these properties and not spread in the detailed plant accounts themselves?

Q. Well, I had understood the first to be your answer. But I am quite willing to accept the correction. It amounts to the same thing, of course.

A. You don't mean that after an amount goes in 100.5 it shall be taken out and put back into detailed plant accounts?

Q. No, no, no.

A. I am assuming you do not.

Q. No, no, spread, as far as amortization is concerned, over the life of the individual items of property.

A. Yes, sir.

Q. Contained in 100.1 accounts?

A. Yes, sir. We understand one another.

Q. Since my question is a little long I hand it to you, as a matter of fairness.

Mr. Smith, we have already talked about the "A" company and the "B" company. Let's assume now three companies, which we may designate "C", "D" and "E" companies, all having identical physical equipment, let us say 5,000 [582] kilowatts each of generating capacity, 1,000 miles each of transmission lines, 2,000 miles each of distribution lines, with all appurtenant equipment. Let us assume, further, that these companies operate in a similar territory.

Now, let us assume that "C" company constructed all of its own property but did not include in con-

(Testimony of Charles W. Smith.)

struction cost either any interest during construction, or any administrative or general overheads.

Let us also assume that Company "D" purchased all of its properties as operating units from companies "X", "Y" and "Z", the latter companies having records which are either completely inadequate or non-existent, so that company "D" is required to resort to estimates for the purpose of reclassifying its electric plant account.

Third and last, let us assume that company "E" constructed all of its own property but charged to construction full interest during construction and all applicable administrative and general overhead.

Please explain to what extent the application of the Commission's system of accounts in these three situations, companies "C", "D" and "E", would be expected to produce consistent or equitable results.

A. You changed a word on me. As far as "consistent" is concerned, each one would be consistent with its own past practice; and that is the important point in regard to con- [583] sistency.

As far as "equity" is concerned, why it is most equitable if a company has kept its records on a certain basis which conforms to accepted principles of accounting, and has published financial statements on that basis, which statements have been used by stockholders, by credit agencies, by taxing authorities, and by regulatory bodies, to stick to

(Testimony of Charles W. Smith.)

that basis. That is the only equitable way to handle the situation."

I think that is perfectly consistent. I agree with you—at least I make this statement, that "A" was charged administrative expense,——

Q. (Interrupting) No, "C", you mean. "C", "D" and "E" are the companies.

A. That is right. That "C" which charged administrative expenses to expenses and did not capitalize them, should not be permitted to capitalize them now. And I repeat again, that utilities throughout the United States today, which are not capitalizing those items, should not in the future be permitted to go back and capitalize them. As far as interest during construction is concerned, I repeat that actual bona fide interest costs, identifiable interest costs, could be capitalized as the correction of an accounting error.

Mr. Priest: Will you read me that answer again, Mr. Reporter? [584]

(Answer read.)

By Mr. Priest:

Q. Now, will you go on to discuss "D" and "E" companies, Mr. Smith?

A. You wish me to discuss the accounting under the Uniform System of Accounts, Mr. Priest?

Q. That is right.

A. "D" company purchased all of its operating units from "X", "Y" and "Z". The other companies either had inadequate records or records

(Testimony of Charles W. Smith.)

which are non-existent. So "D" company has to determine the original cost of those properties by estimates.

First of all, that is a claim by many utilities, and we find in most cases there are adequate records.

Q. Let's stay with our assumption, please.

A. I want to make that statement because of the widespread belief that there are inadequate records, which we have found to be wrong.

Secondly, I would say to you that we would do our utmost to try to find out what "X", "Y" and "Z" did in their accounts, and I think we would find out. I think we would find out. If not, we would have to make an assumption.

Q. And if estimates were based upon the provisions of the Uniform System of Accounts, those estimates would necessarily, as a matter of self-interest, from the point of [585] view of the accounting company, include interest during construction and general and administrative overhead.

A. My point was that if we found "X", "Y" and "Z" had charged those items to expense, we would not allow "D" to restate them. And if we didn't know, we would have to make an assumption on the best evidence; and maybe the assumption would be that "X", "Y" and "Z" did charge those things to plant, in which case we would go along with "D" in estimating the amounts.

In other words, our principle would be to find out what "X", "Y" and "Z" did. As a matter of

(Testimony of Charles W. Smith.)

practice, I am willing to admit readily, admit at once, without qualification, that sometimes we cannot get the information we need, and we have to make the best of a bad situation. But we adhere to principles and wherever we can get the information we abide by those principles.

I am not saying that we can do a perfect job in this original cost work. I know we can't.

Q. Then in the example that we are talking about, the original cost of the "C" company might differ substantially from the original cost of the "D" and "E" companies, is that right?

A. It would differ from the "E" company and it might differ from the "D".

Q. Then, Mr. Smith, the consistency that you spoke of [586] on your direct testimony, which your system of accounts seems to impose, is with respect to the past practices of a particular company and not consistency as between companies? Is that right?

A. Well, consistency in accounting necessarily means consistency in the same company's practices throughout the years.

Q. So that there might be wide inconsistencies, wide variations, as between the results achieved by one company and the results achieved by another company, based on the accounting idiosynerasies and policies of one company as against another, is that right?

(Testimony of Charles W. Smith.)

A. I don't want to subscribe to your word "idiosyncrasies"; but I will say to you as a matter of practice there are substantial variations, throughout all industries. Our Uniform System of Accounts brings the practices into closer harmony than in any industry of which I have knowledge.

Q. Mr. Smith, you spoke, I think in your direct testimony, of the doing of mischief as a result of the capitalization of items previously charged to operating expenses. Is that correct? That mischief would be done by such a practice? Is that right?

A. If it is continued, yes. I don't recall my exact words, but I will say this, that there will be a great mischief if you permit a company to charge these items to expense [587] and then restate them.

Q. Well, now, Mr. Smith, would any mischief be done by the inclusion of red figures, credit items, whether resulting from the restatement of overheads or otherwise, in account 107?

A. Why, if they are bona fide amounts, no; but if they are pure re-accounting items such as I have condemned, I think mischief would be done.

Q. Why?

A. Because you increase, automatically, your plant account, which is a balance sheet item; and you show as a red figure, not your plant account, but another balance sheet item.

And then it comes to the question——

Q. (Interrupting) May I interrupt you just a moment? You don't increase total plant, do you?

(Testimony of Charles W. Smith.)

A. Yes, you do. You don't increase the total plant plus account 107, but I am defining total plant as being account 100. That is the balance sheet item. 107 is another co-equal balance sheet item. Now, the two of them together are not increased.

Q. Of course the result may still not be in excess of actual cost, is that right?

A. The result might not be in excess of actual cost, but you can't stop there. The next question is: What are you [588] going to do with the credit items? Our system of accounts provides for the depreciation of the original cost. If you apply the same principle to the credit balance of 107 and have a credit in depreciation account, then certainly there is no reason why the adjustment should be made because you are right straight back where you were in the beginning and you are going through a lot of accounting details and entries for nothing. And if you don't do that, I think mischief will be done.

Q. Of course, in any event you would not permit the credit balance in 107 to be transferred to surplus?

A. No, sir; no, sir. That would be bad accounting, extremely bad accounting.

Q. But you might permit the credit balance in 107 to be transferred, let us say to the depreciation for reserve?

A. No, I would not do that. I say that there may be some argument that the credit balance should be credited to depreciation expense. But if you do that

(Testimony of Charles W. Smith.)

the entire reason for restating the account disappears and you are going through a great deal of accounting adjustments for nothing.

Q. You said in your direct testimony, and I quote now from page 491: "It is contrary to the system of accounts to try to apply these original cost provisions to the utility's own construction in such a way as to increase the amount of recorded cost of construction." Isn't the effect of the [589] interpretation that you have placed upon the system of accounts, particularly upon instruction 2(b) to make Account 107 a one-way street, that is, to produce in Account 107 only debit items, black figures, rather than credit items, red figures?

A. Well, I think that under the natural process the amounts in Account 107 will be debit figures. There may be some cases where you have credit figures, but overwhelmingly they will naturally be debit figures.

Q. What would such credit figures be?

A. The only case I can think of off-hand of a credit figure is where a company has arbitrarily written down its plant accounts below the cost of construction and it wants to correct the item.

Q. That is an actual write-down would be netted against a write-up? Is that right?

A. No. A company has written off a million dollars, and now it wants to add a million dollars to its plant account. The million dollars represented

(Testimony of Charles W. Smith.)

bona fide original cost, but for some reason they charged it off. I can't imagine such a situation existing to that extent, but assuming that it did it would charge the detailed plant accounts and credit account 107.

Q. But such a write-down is the only thing you can think of that would produce a credit item in Account 107?

A. No, 107 is a clearing account for all other adjustments which do not affect Account 105. Now, in our work [590] we have had several credit items in Account 107. I can't think offhand just what they were, but I have run into them in our regular course of business.

I might add, Mr. Priest, that I do not use the word "clearing account" in the technical sense. Our system of accounts has clearing accounts. I mean an account in which we clear certain items.

Q. In cases where original cost may have been fixed by a state regulatory board having jurisdiction, and such original cost has been recorded in the books of the accounting company as such, should the Federal Power Commission, as a matter of principle, require a reaccounting or restatement of the original cost so fixed?

The Trial Examiner: You mean charge back?

By Mr. Priest:

Q. Under your Uniform System of Accounts.

A. I am disturbed about the question involving the Federal Power Commission. I can only speak for myself, as to what I would do in that respect.

(Testimony of Charles W. Smith.)

Q. That is all I am asking you.

A. I would place the greatest credence in the determination of the state commission. We have had one case where a state commission had determined original cost. The company filed a study and we thought a few things should be inquired into. We made a study with the cooperation of the state com- [591] mission. I think we will find a little different result than was found by the state commission, and I think that is the way I would proceed, Mr. Priest.

Q. Under your system of accounts, where factual data are not actually available for the determination of costs, either as to acquired property or in connection with the correction of accounting errors, are estimates of such costs permitted? [592]

A. Estimates are permitted in connection with acquired property. The System of Accounts does not permit estimates in regard to other property. Specifically, it does permit estimates in connection with acquired property.

Q. But it does not, as you interpret it, permit the use of estimates in connection with the correction of accounting errors in case of a company that may have constructed all its own property?

A. No, I would not like to say it would. I think the correction of accounting errors should depend on documentary evidence, primarily. I perhaps can conceive of some cases where serious accounting errors have been made in respect to the failure to record property retired where some estimates may

(Testimony of Charles W. Smith.)

have to be resorted to. But it would be in few cases. The general rule is that documentary evidence is required.

Q. Now, are there any instructions in the System of Accounts as to how estimates shall be made?

A. No sir. The System of Accounts says that costs shall be determined by analysis of the records.

Q. Well, such an analysis might involve the use of estimates, might it not?

A. No; any analysis involves the principle of analyzing documents. You see, the accounting process is a process which is dealing with documents all the time. We like [593] to get back to the documentary evidence.

Q. But in case the documentary evidence were inadequate or absent or deficient——

A. And you wanted to correct the books by increasing the amounts recorded in the books——

Q. No; either way; either increase or decrease.

A. I can see where estimates might have to be resorted to where you know there are unrecorded requirements but I don't see, off-hand, where estimates should be resorted to for other purposes.

Q. In your opinion, would any reasonable and generally accepted basis of estimating costs be acceptable to the Commission?

A. Now you are asking me as to a reasonable basis of estimates. When it comes to estimates of cost,—appraisals of costs. I look upon them pretty

(Testimony of Charles W. Smith.)

much in the same fashion as I look upon reproduction costs. I don't have any real faith in them. And so, as far as I am concerned, I am very, very suspicious, Mr. Priest.

Q. But there are generally accepted methods of estimating a particular item of cost, are there not?

A. Generally accepted methods?

Q. Yes. A. I don't know. [594]

A. I will say, to repeat, that the original cost of two companies, both operating the same kind of business and the same kind of properties, may differ because of the exercise of options which are granted them under this system of accounting, and which they are permitted to exercise within sound principles of accounting. That is true in all businesses, including public utilities. [609]

EXHIBIT NO. 33

EXHIBIT "B"

Northwestern Electric Company

STATEMENT OF INCOME AND PROFIT & LOSS

FOR THE YEARS ENDED DECEMBER 31, 1920 AND 1919, AND COMPARISON

	Year Ended December 31, 1920	1919	Increase Decrease
Operating Revenues—Schedule #1	$1,528,929.28	$1,332,165.28	$196,764.00
Operating Expenses—Schedule #1	$ 818,890.81	$ 666,825.64	$152,065.17
Net Operating Profit Before Providing for Depreciation	$ 710,038.47	$ 665,339.64	$ 44,698.83
Other Income Credits:			
Rents	$ 614.44	$ 331.51	$ 282.93
Interest and dividend revenue	20,700.40	21,635.41	935.01
Miscellaneous	739.35	2,736.08	1,996.73
Total	$ 22,054.19	$ 24,703.00	$ 2,648.81
Gross Income	$ 732,092.66	$ 690,042.64	$ 42,050.02
Income Charges:			
Interest:			
On funded debt	$ 346,710.00	$ 327,583.16	$ 19,126.84
On notes and accounts payable	67,064.67	56,346.59	10,718.08
Total	$ 413,774.67	$ 383,929.75	$ 29,844.92
Less interest during construction charged to capital		49,955.12	49,955.12
Remainder	$ 413,774.67	$ 333,974.63	$ 79,800.04
Amortization of preferred stock expense	300.00	300.00	
Provision for Federal income taxes	15,781.18	23,860.58	8,079.40
Miscellaneous		50.00	50.00
Total	$ 429,855.85	$ 358,185.21	$ 71,670.64

Other Income Credits:			
Rents	$ 614.44	$ 331.51	$ 282.93
Interest and dividend revenue	20,700.40	21,635.41	935.01
Miscellaneous	739.35	2,736.08	1,996.73
Total	$ 22,054.19	$ 24,703.00	$ 2,648.81
Gross Income	$ 732,092.66	$ 690,042.64	$ 42,050.02
Income Charges:			
Interest:			
On funded debt	$ 346,710.00	$ 327,583.16	$ 19,126.84
On notes and accounts payable	67,064.67	56,346.59	10,718.08
Total	$ 413,774.67	$ 383,929.75	$ 29,844.92
Less interest during construction charged to capital		49,955.12	49,955.12
Remainder	$ 413,774.67	$ 333,974.63	$ 79,800.04
Amortization of preferred stock expense	300.00	300.00	
Provision for Federal income taxes	15,781.18	23,860.58	8,079.40
Miscellaneous		50.00	50.00
Total	$ 429,855.85	$ 358,185.21	$ 71,670.64
Net Income Before Providing for Depreciation	$ 302,236.81	$ 331,857.43	$ 29,620.62
Surplus at Beginning of Year	$ 420,740.72	$ 301,101.29	$119,639.43
Gross Surplus	$ 722,977.53	$ 632,958.72	$ 90,018.81
Profit & Loss Charges:			
Dividends on preferred capital stock	$ 112,218.00	$ 112,218.00	
Provision for depreciation of plant and equipment	100,000.00	100,000.00	
Loss on sale of investments	932.67		$ 932.67
Total	$ 213,150.67	$ 212,218.00	$ 932.67
Surplus at End of Year	$ 509,826.86	$ 420,740.72	$ 89,086.14

(Testimony of Charles W. Smith.)

By Mr. Slaff:

Q. Mr. Platt, in the event the company's method should be approved by the Federal Power Commission, do you propose to advise the various taxing units that your statement as to the property of your company previously submitted to them for past years has been changed?

A. With respect to those items re-accounted for?

Q. Yes, with respect to your property, the amount of your property.

A. You mean to give effect to these items that are re-accounted for?

Q. Why, yes. So that it will be perfectly clear, say the year 1935 you reported to a given taxing unit in this state or in the State of Washington, that your property for that year cost you "X" dollars. Do you propose to report to such taxing units now that your property, at that year, cost you "X" plus "Y" dollars?

A. I don't believe it calls for any such treatment; that these items that we are re-accounting for are not in effect changing our utility plant account. Our utility plant account will remain the same. These items that will be re-accounted for are a credit to Account 107.

Q. And don't you report your book costs, broken down in great detail, as you told us before recess, on cost of lines, sub-stations, conduits and cables and poles, in [642] such great detail as you described earlier this afternoon?

(Testimony of Charles W. Smith.)

A. The property as such will be the total property of the company, and the utility——

Q. Why do they require all of that detail?

A. Well, I will answer your question another way.

Q. Surely.

A. I don't know what action I will take when that time comes.

Q. Have you given the problem—You recognize that as a problem now, do you not?

A. I recognize it as something that will require study and attention.

Q. And up to this moment you have given it no study or attention; is that right? A. No.

Q. That "No" means that it is correct that you have given the problem no study or attention?

A. I have given the problem no study or attention.

Q. Now you have a similar problem with respect to your income statements for those years, and the taxes, based upon your income, do you not?

A. Yes. [643]

Q. You stated at page 123 and 124 of the transcript, in response to a question from the Examiner, as follows: "I know that when this system of accounts was proposed, a lot of companies were very much disturbed by what we considered some new ideas that were included therein, and which we thought were contrary to sound accounting practice." Is that correct? A. That is.

(Testimony of Charles W. Smith.)

Q. Now, as I gather from your testimony, the general purport of your testimony, one of the matters which most disturbed you and which was very disturbing, was electric plant [656] instruction 2(b), and its alleged inconsistency with other instructions and accounts, is that correct?

A. Yes. [657]

Q. Was that attitude one that you had before November, 1938 or after that date? That date, you will recollect, is the date of the letter from you to the Commission in evidence here as exhibit No. 20. You recollect the letter I have in mind, do you?

A. I do. Well, with regard to a number of the provisions in the classification, including the one in Electric Plant Instruction 2 (b), I have been concerned, not only since 1938, but I have been concerned prior to that. It is probably in order here to remark that the more we studied this classification after its issuance and talked to the men in the industry, the more we realized the character of the changes which its use would require.

Q. Yes. Well, I observe rather, what appears to me to be a rather elaborate 37-page document which was submitted by your company and the Pacific Power & Light Company on December 11, 1936 to the Public Utilities Commissioner of Oregon, headed "Comments and Suggestions with Respect to the Adoption of a Uniform System of Accounting for A and B class Electric Utilities". Can you tell us in what connection you submitted that to the Oregon Commissioner?

(Testimony of Charles W. Smith.)

A. That was in connection with a hearing before the Oregon Commission that we had with respect to the adoption of this classification of accounts.

Q. And the very classification, or one identical [658] with the classification of accounts of the Federal Power Commission, admitted in evidence here as Exhibit 6? A. Yes.

Q. Now, you didn't at that time, did you, within that report of comments and suggestions, call that matter to the Oregon Commission, or for that matter to the Federal Power Commission, as to the grave disturbance that then existed as to instruction 2(b)?

A. I don't recall whether that item was dealt with or not. [659]

Q. Now, at page 629 of the transcript of the testimony, in discussing with you my recollection that you had testified before the Oregon Commission with respect to request or requests by your sole common stockholder, the following question and answer between us took place:

"Q. Well, I don't have it in my notes before me at the moment, but my recollection is that you did so testify before the Oregon Commission under examination by Mr. Clark, and if you care to go back into your memory I think you will probably recollect that you did so testify that it was a fact that at least on one occasion that I can now recollect, and perhaps on more than one occasion, that

(Testimony of Charles W. Smith.)

request was made by your sole common stockholder upon your company for the declaration of a certain specific amount or percentage of dividend on the common stock, and I take it we are in substantial agreement with respect to that."

Have you had an opportunity to verify the certainty or to assure yourself as to the certainty of that fact or those facts?

A. I did so testify that the common stockholder made a request. I think in my testimony yesterday I explained that either directly or by inference that such a request did not take away from the Board of Directors their full authority to act on their own judgment in the matter.

Q. Well, a request was made in 1928 by a representative [676] of your sole common stockholder suggesting a dividend of $100,000, is that correct?

A. That is correct.

Q. And in the following year there was a request from the sole stockholder that the dividend be increased, the dividend to be declared in that year be increased over the dividend declared the previous year? A. Yes.

Q Now, you have testified, I think, several times in the course of this proceeding that with respect to the allocation of overheads between construction and operation, your practices are the same after January 1, 1937, as they were immediately prior thereto? A. That is right.

(Testimony of Charles W. Smith.)

Q. And is it your contention in this proceeding that the manner in which your books were kept prior to January 1, 1937, was not in accordance with the present Federal Power Commission accounting order, more specifically Exhibit 6 in this case?

A. As I interpret the provisions of the Electric Plant Instruction 5 defining the elements of cost, I believe that the method of determining cost should include, charged to construction, the overheads which, in the company's filed statement of original cost, have been treated as re-accounted for. [677]

Q. Well, I think we understand that to be your position, Mr. Platt. However, is it fair to say, then, that it is your contention that your books were, in that respect, prior to January 1, 1937, were not kept in accordance with the present Federal Power Commission system of accounts, Exhibit No. 6?

A. Did you say "intention" or "contention"?

Q. Is it your contention? A. It is.

Q. Then it follows from that, does it not—in the same respect your books for the years 1936, 1937, 1938 and 1939 have not been kept in accordance with the Federal Power Commission's system of accounts, Exhibit 6?

A. As I now interpret it.

Q. And as you have interpreted that since when?

A. I think that I testified that our study of this classification of accounts was rather progressive in character, and that it was in the spring of 1939.

(Testimony of Charles W. Smith.)

Q. March or April, I think you said?

A. I believe so, that we reached the conclusion that a proper statement of costs should include these items.

Q. Well, so that we can say that in the spring of 1939 you reached the conclusion that, with respect to these matters, at least, your books and accounts were not being kept in accordance with the accounting orders of the Federal [678] Power Commission? A. Yes.

Q. After reaching that conclusion, however, Mr. Platt, you did swear, did you not, that your books and accounts were being kept in accordance with the accounting orders of the Federal Power Commission?

A. I testified previously in this hearing——

Q. Could you answer that question, Mr. Platt, before you proceed into an explanation?

A. Yes. I testified——

Q. And the answer to the question is "Yes"?

A. The answer to the question is "Yes". I testified previously in this hearing, however, that there still was in our minds a knowledge of a controversy which was to arise on this issue, and that a determination of the question would grow out of such a proceeding as this.

Q. But you have just testified here as to the spring of 1939, to the best of your knowledge and belief, your books of account were not being kept in this respect that we have been discussing,—were

(Testimony of Charles W. Smith.)

not being kept in accordance with the accounting orders of the Federal Power Commission.

A. As I interpreted them—however, subject to my knowledge that this was a moot question, and therefore I considered it wise and consistent to continue to [679] report as heretofore, until a solution of this problem could be reached.

Q. You continued to report your accounts—continued to keep your accounts as before?

A. Keep our accounts and report them as theretofore, in order to be consistent until this controversy, which I saw was inevitably going to arise, would be resolved.

Q. And with respect to your accounts, which you kept as before and which you now have testified were, to the best of your knowledge and belief, not being kept in accordance with the Federal Power Commission's System of Accounts in this particular respect, you did however, swear in your reports to the Federal Power Commission that your accounts were, to the best of your knowledge and belief, being kept in accordance with the accounting orders of the commission? That is a fair statement, is it not? A. It is. The answer is "Yes".

Q. And the same is true with respect to the reports which you filed with the Washington Commission and the Oregon Commission? A. It is.

[680]

(Testimony of Charles W. Smith.)

Q. If the Federal Power Commission does not approve your re-statement, as proposed by you in this proceeding, but instead follows the staff recommendations as contained in the Joint Report, and as testified to by Mr. Smith it will not affect your company's ability to continue its business in the future just as it has in the past?

A. The company will be able to continue to give service as it has in the past. Just as to what the ultimate result of recording on the company's books, its electric plant accounts at less than we think is the cost thereof, I just don't know at this time.

Q. And at what you have thought to be the cost thereof for many, many years; isn't that——[682]

A. Yes, we have brought these three stated accounts in here partially in correction of actual errors, as for example, as for interest on specific construction work, and other items probably, probably not so much in the correction of errors, but in response to the requirement that we re-classify our accounts under definitions which we have interpreted so to require.

Q. Now you say you will be able to continue to render service that you say you have rendered. You will also be able to continue doing a profitable business, if the market remains for your service; isn't that so?

A. Just at the present moment, I don't see any reason for answering that in the negative.

Q. Well, then, your answer, I take it, is in the affirmative?

(Testimony of Charles W. Smith.)

A. Well, it is subject to a reservation with respect to anything which I do not presently foresee arising therefrom.

Q. Well, but I am speaking only as to those things which you can presently foresee, of course.

A. With respect to the things that I can presently foresee, yes.

Q. And the adoption by the Commission of the recommendation of its staff would not affect the market for your services? [683]

A. It would not.

Q. And of course the adoption of those recommendations of the staff by the Commission certainly would not affect, in the slightest, your ability, as Chief Accounting Official, to continue to record on your books, as you have done for the past 15 years, the cost of your plant and the expenses of your operations?

A. We would still be able to record the costs and the revenues, and other things, which reflect the operations of the company, as in the past.

Q. As in the past. Well, I will get to that. And, as I say, the adoption of these recommendations by the Commission, if it should so adopt them, would not affect your ability to do so, in the slightest? That is a fair inference?

A. It would not.

Q. Can you tell us, Mr. Platt, what "value" is? [684]

The Trial Examiner: The Court is having trouble with that, too, Mr. Slaff.

(Testimony of Charles W. Smith.)

Mr. Slaff: That is exactly the point, Mr. Examiner, that I think Mr. Platt and I will be able to develop.

The Witness: I wish I had the background of being a school teacher that Mr. Smith has.

A. This question of value obviously has so many aspects, and controlled by the opinions of the person who seeks to acquire property or services and by the opinions of those who sell or furnish property or services, by market conditions and otherwise, that I do not believe that, short of writing a treatise on it, that it is possible in any reasonable space to give definition to it.

If the question were to be asked from the standpoint of what is the value of a thing in the market, it might be possible to answer that. But unless the question can be made more concrete, and in view of the difficulties of definition as, for example, applied to utility property, I just feel constrained to say that I can't give you a definition of it for the purpose.

Q. I think both of us agree with Justice Brandeis that value is a word of many meanings.

A. Yes.

Q. In addition to the different methods of arriving at value, you recognize that there are different kinds of [685] values, values for different purposes? A. That is true.

Q. With respect to the same article of property, that is so?

(Testimony of Charles W. Smith.)

A. An article might have a greater value to one man, if he desired to acquire it, than to another man.

Q. It also might have a different value to the same man, or, the same man might represent it to have a different value for a different purpose, as for example, let's get back to your plant, for rate-making purposes, you state that the plant has a definite value. That is correct, is it not, when you are in rate proceedings, either formally or informally? A. That is true.

Q. Now, that value may be different from the book value of that property? Isn't that so?

A. Yes.

Q. And in fact has been as presented by your company in the past?

A. As far as I can recall, Northwestern Electric Company has never fixed a value as such for rate-making purposes. It has, in response to requests of the State regulatory authorities, presented what it has shown on its books as proven historical cost. It has also presented at the request of the regulatory authorities reproduction cost, which the [686] regulatory authorities feel, I assume, since they ask for them, had some bearing upon the rate base.

Q. Have you completed? A. Yes, sir.

Q. And the company has made representations, has it not, in those very connections, as to its conception as to the value of its property for rate-making purposes?

(Testimony of Charles W. Smith.)

A. Well, I don't recall whether we have actually presented any definite sum.

Q. Oh, Mr. Platt, hasn't your company represented to the Commission in rate cases what it conceived to be the value for rate-making purposes in the proceeding?

A. I just am not able to answer that question with certainty and assurance.

Q. You took an active part in such rate proceedings, didn't you?

A. An active part with respect to the compilation of statements of historical costs.

Q. Well, Mr. Platt, we can pass that by, I suppose, and go on.

Your company also makes representations, does it not, as to the value of the property for taxing purposes? A. It does.

Q. And the value of its property for taxing purposes is not the same as the value of the property for rate-making [687] purposes or the same as the book value of the property?

A. The company has furnished tax authorities with statements of its historical book cost. But anyone who has ever worked in tax matters knows that the book value for tax purposes is seldom, if ever, on the same basis as the determination of a rate base.

Q. I think we are in entire agreement as to what the fact is in that connection. And the value of the property might be different for one taxing purpose than for another taxing purpose? Isn't that so?

(Testimony of Charles W. Smith.)

The Trial Examiner: Are you speaking of intangible values?

Mr. Slaff: Sure, property taxes, franchise taxes, the development of a value for either one of them.

The Trial Examiner: Either has more of an intangible——

A. The answer to the question would seem to imply that the company itself designates the value for——

Q. (Interrupting) Now, Mr. Platt—go ahead.

A. ——for that purpose.

Q. Let me clear up any apprehension that may be in your mind.

The Trial Examiner: Pardon me. Just disregard the implication and answer the question if you possibly can. As I recall, the question was merely whether or not the value on the property for different types of taxes, if it [688] does not vary. Wasn't that the question?

Mr. Slaff: Surely. That is all.

Mr. Laing: The question is in the abstract, rather than in reference to any particular property, was it not?

Mr. Slaff: Yes, it was, but I am narrowing this down to a particular company simply so that we cannot be charged with dealing with vague abstractions, but in dealing with realities. Our concepts are very practical.

A. The point that I have in mind that is causing me to hesitate is that when it comes to the de-

(Testimony of Charles W. Smith.)

termination of value for property taxes, for example, although the company may seek to influence the tax assessor for tax purposes to put a lower value on the property, yet in that particular instance the company does, as I have already stated, present a statement of historical cost, and so offers it.

By Mr. Slaff:

Q. Mr. Platt, please be assured that I am not attempting to charge by implication what you think is in my question, any reprehensible practices in the past by your company.

A. I do not have that thought.

Q. Well, fine. I was rather afraid that perhaps you had that thought in mind.

A. We have already discussed the need of placing valuations on the company's property for the assessment of property taxes. Now, we have one other question where the company's [689] property is set forth in a statement pertinent to taxation, viz., a schedule which informs the Internal Revenue Department for income tax purposes that the company has certain property.

Q. And the value of your property as there set forth may well and undoubtedly is something different from the value of your property as set forth for other taxing purposes, is it not?

A. As I recall it, under the rules of the income tax procedure, the schedules of property designed to form a basis of—a basis for the calculation of

(Testimony of Charles W. Smith.)

depreciations have taken from them the intangibles, which are considered as non-depreciable property; and therefore, although otherwise, which I believe to be true, the schedule of value is in fact the schedule of historical cost. [690]

Q. Well, that is to say the value for income tax purposes, which you say is the historical cost, is the historical cost less the deduction that you have taken or been allowed for income tax purposes for depreciation in the past; is that correct?

A. No, I don't believe so. I believe that the base remains the same, affected only by additions and retirements.

Q. Now value for purpose of eminent domain, as far as your company or any other company is concerned, may be still a different value from any of the values which we have discussed so far?

A. Yes.

Q. The value of additions to your property, which might serve as the basis for the issuance of additional bonds under an open-end mortgage might and frequently is still something different from the value which we have thus far discussed?

A. It is certainly different from tax values.

Q. It might well be different from value for rate-making purposes, too?

A. In the abstract, it might be, considering that we have not yet defined its applicability to the Northwestern Electric Light Company, what the rate base is or what a rate base is. [691]

(Testimony of Charles W. Smith.)

Q. Concretely, too.

A. Not necessarily.

Q. The chances are pretty good that it is something different, aren't they, as far as you are concerned? A. That does not follow.

Q. Well, do you have any open-end mortgages in your company? A. We do.

Q. What is the difference with respect to net additions to the property?

A. The provision is that in net additions to the property upon certain established ratios may be used for the issuance of bonds.

Q. Now is it your conception or your company's conception that additions represent rate base?

A. We have not defined rate base.

Q. You have given it a lot of thought, haven't you?

A. It has been given a great deal of thought in our organization.

Q. Sure.

A. I might add that there was nothing indicated in this proceeding that had any bearing on rate bases, and I did not come here, prepared by any study, to discuss such a question.

Q. No; I only want to discuss at this time the prob- [692] lem of value with you, because that is a problem, is it not, in this proceeding?

A. Not in this proceeding.

Q. Haven't you testified as to value in this proceeding? A. The question of value is.

(Testimony of Charles W. Smith.)

Q. Yes.

A. But the question in value of terms of a rate base is not.

Q. Oh, no, I think we are in thorough agreement as to that, Mr. Platt. But we are presumably concerned with the problem of value, which you brought up in your direct testimony.

A. We are concerned with the question of value as determined or confined to—confined in its determination in this determination of original cost. I don't understand that there is any issue here other than that of the determination of original cost.

Q. Well, then I take it that we can be in agreement that, as far as the stock issue of this company is concerned, the common stock issue, the only problem involved is original cost to the company of the services for which those stocks were allegedly issued.

A. No.

Q. So we do have a different problem, which you [693] have introduced in this case, than original cost; isn't that so?

A. We have this problem as pertains to the common stock.

Q. Well, can you answer that question? Answer that question. We will get around to the problem of the common stock, Mr. Platt; have no fear about that.

We do have a problem different, then, according to your light, from the one solely of determining original costs?

(Testimony of Charles W. Smith.)

A. May I have the question?

(Question read.)

A. No, I don't think we do.

Q. Well, do we have, with respect to the issue of the common stock by this company, a problem, according to your conception of determining the original cost to the company, or the cost to the company of the services for which such stock was originally issued? A. Yes.

Q. And I understand your direct testimony to have been that in that connection the problem involved in this proceeding was that of determining the value to the incorporators or the promoters of the stock issued to them; is that correct? [694]

A. The company in this proceeding is acting in response to the provisions of Electric Plant Instruction 3(D), which reads: "Where the consideration given for property is other than cast, the value of such consideration shall be determined on a cash basis." Now, in reaching such a determination on a cash basis, it seems to me perfectly obvious that [696] we must have recourse to every evidence of value that we can find. And answering your question directly, the value to the promoters, which we do not now know, may or may not have been fully indicative of the value we are now seeking to determine.

Q. All right. We will return to that in a moment. Just for the purposes of the record, you had an opportunity, did you not, during the recess, to consult on this problem with your advisors?

(Testimony of Charles W. Smith.)

A. Such an opportunity was afforded.

Q. And you did so consult with counsel and other advisors?

A. I did, and I stated my views, and they concurred.

Q. You consulted with Mr. Barber of counsel?

A. I did.

Q. And with Mr. Hatch, of EBASCO Services, Inc.? A. I did.

Q. And with whom else?

A. And Mr. Laing.

Q. And with whom else?

A. And that is all.

Q. So that we can now assume that that is your position as you have now stated it, if you have completely stated it; but at least, insofar as you have stated it, [697] it represents the company's position in this proceeding, does it? [698]

A. First, let me say that when I say there was concurrence with the statement I made, or the answer to the question, I am quite sure that that was broader than I should [699] have made it. There was an exchange of opinion that I have put into my own words, finally, my own considered opinion.

Q. Well——

The Trial Examiner: And that is your opinion, is it not, Mr. Platt? A. That is true.

By Mr. Slaff:

Q. You are the person charged with the sole responsibility on behalf of your company of testi-

(Testimony of Charles W. Smith.)

fying in this proceeding with respect to the stock issued by the company to the promoters of the company? Is that not so?

A. I have offered the sole testimony up to this point.

Q. And up to this point you have been charged with the sole responsibility by your company as to testifying in that respect, and we have a right, do we not, Mr. Platt, to expect and to count upon the fact that your expressions with respect to this matter are your company's expressions with respect to this matter? A. Yes.

Q. Then it is a fair statement that the opinion which you expressed and the statement which you made upon the resumption of the hearing after recess, represents the company's position in this procedure? [700] A. It does.

Q. All right. Now, you did state, with respect to this problem, at page 269 and 270 of the testimony, in respect to the regulatory proceedings pending in Oregon and Washington, as follows: "In 1933 and 1934 the officers of the company under its present management were called upon by regulatory proceedings then pending in Oregon and Washington, respectively, to appraise the historical cash cost to the company on the prudent investment theory, of the services received by it from the organizers in exchange for the 100,000 shares of stock. This problem was distinctly not one of determining the value of the stock issued to the organizers for their serv-

(Testimony of Charles W. Smith.)

ices, or of appraising all the intangible values created or contributed by these organizers, but one of determining, in the absence of a cash transaction at the time, what the cash cost of such services might be if then paid for in cash by the company." That is correct, is it not? A. That is right.

Q. And you also testified at page 273, as follows: "As I have already indicated——"

The Witness: Excuse me just a minute. I want to make a note.

Mr. Slaff: Yes, surely.

The Witness: All right, Mr. Slaff. [701]

By Mr. Slaff.

Q. "As I have already indicated, these discussions in 1933, 1934 and 1936 of certain phases of the organizers' services did not represent attempts to determine the value of the consideration given by the company, viz., the 100,000 shares of stock, for the values contributed by the organizers in putting the enterprise into readiness to do business as a successful, going concern." That is correct, is it not?

A. That is correct.

Q. Now, with respect to your statement at 269 that this problem, the one you had in 1933 and 1934, was distinctly not one of determining the value of the stock issued to the organizers for their services, that was not a gratuitous statement or comment by you in your testimony, was it?

A. Will you read that question, please?

(Question read.)

(Testimony of Charles W. Smith.)

A. Will you read that again?

(Question reread.)

A. It was a factual statement.

Q. And as a fact, you did not throw it in gratuitously in the record, but you put it in because you thought it had a pertinent bearing on these proceedings, is that right? A. That is right.

[702]

Q. And you were making a very sharp distinction be- [702] tween the problem which you say you had before you in 1933 and 1934 and the problem in this respect which you say confronts you in these proceedings?

A. Yes, the problems are different. At that time I was attempting to place a value on such identifiable items as were susceptible of being evaluated and not to place a value on stock.

Q. And what were those identifiable items upon which you were attempting to place a value at that time?

A. There were three of them. One was what might be referred to as nominal compensation for their time over a period of three and a half years; the second was their services in selling an issue of preferred stock without expense to the company; and the third was an attempt to evaluate their loan of credit to the company.

Q. And all those three items represented, did they not, the efforts and services and accomplishments of the promoters?

(Testimony of Charles W. Smith.)

A. Well, they represented such of their efforts and accomplishments as could be specifically tagged with some element of cost which the company might have been required to pay, if it paid for them as such.

Q. Well, these items which you have enumerated represented, did they not, the efforts, the services and accomplishments of the organizers in putting the company into [703] readiness to do business?

A. I should say that the evidence is that they did not represent all, in view of the fact——

Q. (Interrupting) We are not talking about the value which you may have placed upon these items at that time. We are talking of the items themselves, which you enumerated, as being three: First, which is services over three and a half years; second, promoters selling preferred stock without expense; and third, the loan of their credit, which you say they gave to the company, put at the disposal of the company. Those three items represented the efforts, services and accomplishments of the organizers of the enterprise by way of putting it into readiness to do business, is that correct?

A. I don't know that they represented all of such efforts.

Q. Well, can you at this time enumerate any other efforts?

A. No, because at this time I am not trying to present in this proceeding any inventory of their efforts and accomplishments, nor, in fact, to tag

(Testimony of Charles W. Smith.)

them with—such as I can identify, with any dollar signs.

Q. You have tagged them at three and a half million dollars, have you not?

A. Through another approach.

Q. Go ahead. [704]

A. I am attempting to conform to the classification which says: "When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis."

Q. Read the next sentence, will you?

A. "In the entries recording such transactions, the actual consideration shall be described with sufficient particularity to identify it".

Q. That is right. Now, the next sentence.

A. "The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration, if other than cash." That I am prepared to do.

Q. Yes, but you can't tell us at this time that other efforts or services of the promoters there were by way of putting the company in readiness to do business, other than the three items which you have enumerated?

A. After the lapse of 28 years and a change in management——

Q. (Interrupting) Well, you can't tell us any other efforts or services of the organizers that you know of? A. Yes.

(Testimony of Charles W. Smith.)

Q. Other than the three that you have enumerated? A. Yes, there is one other. [705]

Q. Good. Tell us about it. What is it?

A. The organizers first made arrangements for the furnishing of service to an unusually large customer of the company.

Q. Who was that customer?

A. The paper mill at Camas.

Q. In which the promoters of the company were heavily interested, as owners? Isn't that true?

A. That is true.

Q. All right. Go on.

A. And consummated the understanding which they had after the corporation was organized by—entered into a contract that ran for a period up to 1955.

Q. With the paper mills?

A. With the paper mills. That is something that was brought in that made a fine base load for the company.

Q. That was part of their services, was it not, which you evaluated in your testimony before the Oregon and Washington Commissions?

A. There was no reference made to that.

Q. Wasn't that a part of their services which you evaluated in those proceedings, regardless of whether you made reference to it, Mr. Platt? Can't we get an answer here?

A. I have already related—— [706]

(Testimony of Charles W. Smith.)

Q. (Interrupting) Was it part of the services of the promoter which you evaluated in your testimony before the Oregon and Washington Commissions? A. No.

Q. All right. Why did you not evaluate that before the Oregon and Washington Commissions?

A. I evaluated their services on the basis of administrative services to the company.

Q. Their administrative, managerial services to the company? A. Yes.

Q. Isn't that right? A. Yes.

Q. And getting the contract you have just referred to had nothing to do with it?

A. That is something that was arranged in advance.

Q. And you are telling us now that, included within the value which you placed upon the services of this promoter, as testified to before the Oregon and Washington Commissions, there was no consideration by you of this matter of getting this contract with the paper mill, which you have just discussed?

A. That is right.

Q. Now, were there any other efforts or services of the promoters or organizers of the enterprise, by way of [707] getting it into readiness to do business, other than the three which you have enumerated, which you testified to before the two state commissions, and the one you have just mentioned, making this contract for services to the paper mill

(Testimony of Charles W. Smith.)

in which the promoters were heavily financially interested, Mr. Platt?

A. There may be many others. I am not able at this time after the lapse of nearly thirty years since that took place to identify them.

Q. At this time you don't know of any?

A. I do not.

Q. And you are at this time— And you have undertaken to testify, however, on the subject of the value of this stock at the time it was issued in this proceeding, have you not?

A. I have undertaken to place a value on that stock.

Q. And to support the value which you have placed upon that stock? A. That is right.

Q. All right. And you were thoroughly cognizant of that as a problem for a considerable length of time before the commencement of this proceeding?

A. Well, certainly when the company filed its report on or about the first of June, 1939 and included therein this item of organization expense in the amount of $3,500,000.00 I was fully aware of the fact. [708]

Q. Certainly.

A. And that it required support in this proceeding.

Q. And you wouldn't enter that amount on your books unless you were fully prepared to support it at the time you made such an entry?

A. That is right.

(Testimony of Charles W. Smith.)

Q. In other words, at June, 1939 when you submitted your re-statement to the commission you were fully prepared to support that item of value of three and a half million dollars which you had placed on that stock?

A. Yes, having in mind, of course, that in view of the proceedings which were then forthcoming and in which we are now engaged, a final determination of the correctness of my conclusions naturally had a bearing upon the time at which such an entry would be made.

Q. Well, with respect to putting that into your statement, you weren't concerned with the determination by someone else of the correctness of your opinion or valuation. You were concerned then with the correctness as far as you yourself are concerned, of that valuation? A. That is right.

Q. You didn't just want to pluck that out of thin air and put it into your re-statement?

A. No. [709]

Q. So that for fully a year and more you have been well aware of the necessity of supplying and having for yourself, as well as for this Commission, the particulars which went into the valuation?

A. That is right.

Q. Now when did you say that this contract that you referred to with the paper mill was procured?

A. You mean when it was executed?

Q. Yes.

(Testimony of Charles W. Smith.)

A. Probably somewhere in the year 1912, on or about the time that service was available.

Q. I see. And that represented the initial amount of business that the company had, did it not?

A. That was the first business that the company had.

Q. Well, what is the difference between the first business and the initial amount of business that the company had?

A. Well, I don't know that there is any distinction. I am just expressing it in my own terms.

Q. Now you valued the services of the promoters of the company to the company in 1933 and 1934 proceedings, before the two State Commissions; that is correct?

A. That is correct to the extent that it applied to administrative services. [710]

Q. And you valued their services over what period? A. Three and a half years.

Q. Beginning when?

A. The date of organization.

Q. Which is? A. January 1, 1911.

Q. And extending to June 30, 1914?

A. That is right.

Q. And those services which you refer to as managerial did not include this service of theirs in procuring the electrical contracts that you have with the paper mill, that you have described here this morning; is that correct?

A. It is included as an administrative service,

(Testimony of Charles W. Smith.)

closing up the deal, if you care to express it that way, that had previously been arranged for.

Q. When was the deal previously arranged for?

A. As I have already testified, this hydro-electric development of the Northwestern Electric Company——

Q. Can you tell us the date when the service was arranged for?

A. Prior to the organization of the company.

Q. I see. With whom was it arranged for, as far as the company was concerned, prior to the organization of the company? [711]

A. With the paper mill at Camas.

Q. Well, as far as the Company was concerned, no deal was arranged with the company prior to its organization, was it?

A. No deal was arranged with the company. These promoters came in and brought that oral agreement with them, as something which they put into the affairs of the company.

Q. Whom was the oral agreement between?

A. Between the promoters and the people.

Q. And the promoters——

A. Between the promoters of this, operating as, on the one hand, promoters and on the other hand as operators of a paper mill. There is nothing in the record to indicate that the Fleishhackers, although they had a part interest in the paper mill, were either the sole or the major owners thereof.

(Testimony of Charles W. Smith.)

Q. I see. However, with respect to the company itself, you testified that the paper mill contract was executed sometime in 1912, was it,—the middle of 1912? A. Probably about that time.

Q. Now with respect to the company itself, no arrangement could be made with the company, nor could any determination be made by the company with respect to this contract, until after it had been organized? [712]

A. No final contract could be executed.

Q. Well, until the company was organized and knew what was to be constructed, what capacity it would have, what call might be upon it for service, —no arrangements could be made with respect to this contract for service to the papermill?

A. Yes, arrangements could be made. Here were several gentlemen who had in contemplation the building of a hydro-electric project who had, even prior to the organization of the company, used their own funds for engineering investigations.

Q. All of which were repaid to them by the company after it was organized?

A. That is true; but that has no bearing on the fact that, before the company was organized, they did these things, and incidentally put that money in jeopardy in case the thing did not go through and was not a success. And with the understanding which was finally culminated in a contract that, when this hydro-electric plant was completed

(Testimony of Charles W. Smith.)

and ready to do business, that this contract would be entered into.

Q. Well, that was the purpose of the promoters, was it not, to seek a cheap and dependable source of supply for their paper mill business; isn't that so?

A. That was evidently one of their purposes.

[713]

Q. Well, wasn't it their primary purpose?

A. Well, if you say "primary", I think you should consider that inasmuch as it was overwhelmingly their initial load, it could be primary. But the fact that they immediately, and within the period of development, took on a general service in several communities in Washington, and still within the period of development came into Portland, then the question as to whether that was their primary purpose loses its effectiveness, and you are confronted with the fact that they actually did develop a general utility business over a relatively wide area.

Q. Well, there is no doubt in your own mind as to what their primary purpose was, in going out and establishing this hydro-electric plant?

A. That was the thing they had first in mind.

Q. Then why do you cavil at the term "primary", that they had primarily in mind?

A. I don't believe I do.

Q. All right. Now you set a certain value on

(Testimony of Charles W. Smith.)

their services in connection with the proceedings before the Commissions, did you not?

A. I did, as representing what the company might appropriately have been required to pay for those services. If, in determining that value, we were approaching it from the viewpoint of prudent historical cost. [714]

Q. And you testified too, did you not, the reason you believe that $15,000 a year for each of them during the promotion period was a fair amount to put upon their services, you testified as follows: "I believe $15,000 a year for each of them during the promotion period, when they were dealing with more than ordinary difficult problems of carrying out the project and securing the initial amount of business connected, was a little more difficult than in the period from July 1, 1914, and that they were entitled to a greater rate of compensation during that period than they might have claimed thereafter." You did so testify, did you not?

A. That is right. [715]

Q. So that that——

A. (Continuing) ——and that had reference to all the business connected up to the end of the development.

Q. And it is a fair statement to say that, in setting a value upon their services to the company during the period of 1911 to June of 1914, as you did, you considered the more than ordinary difficult problem of securing the initial amount of business

(Testimony of Charles W. Smith.)

connected, to-wit, the contract with the paper mill?

A. No, my use of the word "initial" in that instance had to do with the business which was connected, up to the end of the development period, which I meant as initial.

Q. Well, now, didn't that include the business with the paper mill?

A. It included it, but not to the exclusion of of what I have already stated, that the arrangements had been made for that in advance of the organization of the company.

Q. Is it not a fair statement to say, Mr. Platt, that in evaluating the services of the promoters to the company at $15,000 a year each for the years January 1, 1911, through June 30, 1914, the reason you arrive at a valuation or compensation greater than might have been claimed after that period was the fact that, among others, they were dealing with more than ordinary difficult problems of securing the initial amount of business connected, which initial [716] amount of business included the contract with the paper mill?

A. I gave consideration to the fact.

Q. Is that—— A. No.

Q. (Continuing) ——or is it not a fair statement of fact, and would you like to have the Reporter repeat that to you? A. Yes.

(Question read.)

A. Of course you have asked two questions there. You have asked one with respect to the unusual

(Testimony of Charles W. Smith.)

difficulty of connecting business, and then followed it by another question with respect to one piece of business alone, and therefore——

Q. No, I think you will find that the latter is included within the form of the question.

A. (Continuing) Therefore I cannot answer that question yes or no. I will have to answer it otherwise.

Q. Well, then, go ahead and try to answer it otherwise, and then if we have to we will come back to it.

A. I place that value on the services of the promoters for their services during a period from January, 1911, to June 30, 1914, and whatever they may have done during that period in connection with the paper mill contract, [717] naturally falls within the range of the compensation they were paid. But it does not follow that whatever they may have done prior to that, to make arrangements for the contract ultimately entered into, was a part of the compensation which I have estimated.

Q. Well, was it or was it not—whether it follows or does not — was it or was it not?

A. It was not.

Q. Now, why not? Why didn't you consider that as part of their services?

A. Because I limited the period of their services as administrative officers, and this contract was arranged for in advance of that period.

Q. Well, why did you limit the period?

(Testimony of Charles W. Smith.)

A. Because I was attempting to find out what the Northwestern Electric Company might well have paid them during the period of its own existence.

Q. Do you think the Northwestern Electric would have been interested, assuming that it was separate and apart from the promoters themselves, have been interested in whether they had such a contract available under their control?

A. Will you read that question?

(Question read.)

A. Certainly the company would have been interested in it. [718]

Q. Would that have been an element entering into the compensation that the company would have been willing to pay such promoters for services?

A. No, these——

Q. Your answer is "no"?

A. My answer is no. The services which I have placed a value on were administrative services, having to do with a period between definite dates.

Q. I see. Then it is your statement now, if I understand it correctly, that the fact that these promoters had such a contract under their control, would not be considered by Northwestern Electric in arriving at the compensation to be paid such promoters as executive officers of the company?

A. It would not.

Q. And that is the reason, then, is it, why you made no mention of this matter in your testimony

(Testimony of Charles W. Smith.)

before the State regulatory commissions in 1933 and 1934?

A. I have no means of evaluating that contract, and did evaluate only the things which I could identify and place a value on.

Q. What was the nature of the value of this contract?

A. I don't know what it was worth.

Q. No, I am not asking that at this time, what it was worth. Upon what did the value depend?

A. Well, here was a fine base load, which was con- [719] tracted for, covering a period of forty-five years——

Q. Well, then, let us put it this way, the value of the contract which you say the promoters had depended on or sprang from the ability of the company to do a profitable business with that as a part of its business? A. Yes.

Q. Now, were there any other items, and I think you may have testified with respect to this once or twice this morning already, were there any other items of efforts, services or accomplishments of the organizers of the enterprise, by way of putting it into readiness to do business, other than the three that you enumerated before the State commissions as mentioned here, and the fourth, the paper mill contract which we have discussed, to your knowledge?

A. None that I can identify. I would like to add that what I did in my testimony on this subject——

(Testimony of Charles W. Smith.)

Q. Go ahead.

A. What I did in my direct testimony on this subject was to try to present to this proceeding, for what value it might have, an historical sketch of the origin of the company.

Q. When you say "these proceedings", do you mean the State commission proceedings?

A. These present proceedings. And without regard to the fact that we are here called upon to arrive at the value [720] of the consideration given on a different basis than was required of us in the proceedings before the State regulatory commissions.

Q. Well, I think you made clear several times that you could see that there was a difference in approach in the two proceedings. Now, at page 263 of the transcript you testified as follows, did you not: "While there is nothing in the record of the correspondence with the Commission prior to the service upon the company of the joint report of the examiners to show that any request was made upon the company to supply such particulars,"—referring to the particulars mentioned in Instruction 3(d)—and then you went on to make a statement. That is correct, is it not?

A. That is correct.

Q. When was the joint report served, do you remember? Oh, approximately. It is in the record here. May 1, 1940, wasn't it?

A. About that date.

(Testimony of Charles W. Smith.)

Q. I call your attention to a letter from the Commission, signed Leon A. Fuqua, secretary, under date of June 26, 1939, and ask you whether that refreshes your recollection as to whether at any time prior to the service of the report of the examiners you were called upon for such particulars. [721]

A. The letter to which you refer from the secretary of the Commission, bearing date June 26, 1939, was answered in my letter of July 22, 1939. [722]

Q. Well, Mr. Platt, can you tell us whether or not that letter refreshes your recollection as to whether any request was made by the Commission upon you for such particulars?

A. I am merely trying to get definition of the thing concerning which particulars are asked.

Q. I am just speaking of the particulars which you said at page 263, as to which you said no request had been made prior to the service of the joint report upon you to supply such particulars. Now do you still stand by that statement, that is all?

A. In view of what is contained in this letter, that statement is not correct.

Mr. Slaff: I shall offer this letter subsequently, Mr. Examiner, in connection with the offer of a sequence of correspondence between the Commission and the company in connection with the restatement of the joint report. [723]

JOHN J. O'NEIL,

produced as a witness on behalf of Petitioner, being first duly sworn, testified as follows:

Direct Examination

By Mr. Slaff:

Q. Will you give your full name to the reporter, Mr. O'Neil? A. John J. O'Neil.

Q. What is your profession?

A. I am an accountant.

Q. By whom are you employed?

A. By the Federal Power Commission, in their division of Original Costs.

Q. And what is your capacity in that Division?

A. I am Chief Examiner of Accounts.

Q. How long have you been in the employ of the Federal Power Commission?

A. Since October 19, 1938. From that date until September 1, 1939, my title was that of Principal Examiner of Accounts, and thereafter my title was that of Chief Examiner of Accounts.

Q. As a Chief Examiner of Accounts for the Original Cost Division of the Federal Power Commission, what are your duties? [764]

A. Briefly, my duties consist of making and supervising field examinations of studies submitted by electric utilities relative to the reclassification of electric plant accounts pursuant to Electric Plant Instruction 2-D of the Uniform System of Accounts promulgated by the Federal Power Commission and

(Testimony of John J. O'Neil.)

the Orders of the same Commission adopted on May 11, 1937.

Q. What has been your professional training and practical experience to qualify you for such duties?

A. I graduated from grammar school in 1919, from St. James Academy in 1922, and from Pace Institute of Law and Accountancy in 1925. Thereafter, until August of 1926, I was employed in minor accounting and secretarial capacities. From August 1926 until October, 1927, I was employed as an accountant on the staff of Clifford Yewdall, Certified Public Accountant, during which time I made or supervised a number of annual audits including the reports thereon. In October 1927, I opened an office for the practice of public accounting, and between that date and January 1928 I performed several audits and installed a number of bookkeeping systems for contractors. From January 1928 until September 1936 I was employed by New York Water Service Corporation in the capacity of Chief Accountant. As such, I had complete supervision of all the accounting records of nine separate utility [765] companies, consisting of thirty-two operating plants. During this time I made or supervised a number of original cost studies for the properties over which I had accounting jurisdiction. In September 1936, as a result of a competitive examination, I received the appointment of Senior Public Service Accountant from the Public Service Com-

(Testimony of John J. O'Neil.)

mission of the State of New York. As a result of further competitive examination, my title was subsequently changed to Associate Public Service Accountant. From September 1936 until October 1938, the period of my association with the Public Service Commission of the State of New York, I assisted in two major original cost examinations then being made by the Commission. Since October 1938 I have been in the employ of the Federal Power Commission in the Division of Original Cost, and during that time I have made or supervised seven original cost field examinations.

Q. As Chief Examiner of Accounts for the Original Cost Division of the Federal Power Commission, did you make a field examination of a study relative to the reclassification and original cost of electric plant as of January 1, 1937 submitted to the Commission by the Northwestern Electric Company?

A. I did. The examination was started on December 7, 1939 and concluded on February 10, 1940.

[766]

Q. And the reclassification and Original Cost Study of which you made examination is now in evidence in this case as Exhibit No. 1; is that correct? A. It is.

Q. And where did you make this examination?

A. In the offices of the Northwestern Electric Company, in the Public Service Building, Portland, Oregon.

(Testimony of John J. O'Neil.)

Q. And did any other regulatory body participate with you in this examination?

A. Yes. The examination was made jointly by the Federal Power Commission and the Public Utilities Commissioner of the State of Oregon. Similar to the study filed with the Federal Power Commission, the company had filed a report with the Public Utilities Commissioner of Oregon in accordance with that Commission's Order of September 26, 1938. The examination of these identical studies was made jointly and on a cooperative basis by the staffs of the respective Commissions.

Q. Now did you have any employees of the Federal Power Commission assisting you in this study?

A. I did.

Q. Who were they?

A. Mr. James M. Goodpaster, Examiner of Accounts, and Mr. R. L. Bertolocci, an engineer.

Q. As a result of this field examination of the [767] *of the* company's study of original cost, did you prepare a report to the Federal Power Commission?

A. As a result of the field examination, the staffs of the Federal Power Commission and the Public Utilities Commissioner of Oregon collaborated in the preparation of a joint report. This report was based upon an examination of books, records, contracts and other documents made available for inspection by Northwestern Electric Company, and a review of the files of the Public Utilities Commis-

(Testimony of John J. O'Neil.)

sioner of Oregon and the Department of Public Service of the State of Washington. It represents the joint report of the Commission staffs, and as such was filed with their respective Commissions.

A. And this report that has been filed with the respective Commissions is in evidence, is it not?

A. It is.

Q. As Exhibit No. 3? A. It is.

Q. And that report has, of course, as has been testified to, been served upon the Company?

A. It has.

Q. And contained in that report, resulting from the field examination, are the adjustments and recommendations which you made after an investigation of the company's books and records. That is correct, is it not? [768]

A. That is a Joint Report, resulting from the field examination, and contains the adjustments and recommendations of the respective commission staffs after an investigation of the company's books and records.

Q. Now will you tell us how you went about this field examination which resulted in your report, —the Joint Report which is now in evidence as Exhibit No. 3?

A. The method of procedure in a field examination is to a large extent governed by the nature of the company's study and the extent to which the books and records have already been investigated and examined by local regulatory bodies. In the

(Testimony of John J. O'Neil.)

case of Northwestern Electric Company, as a result of previous investigations of the rates, charges and services of the company, joint examinations had been made by the staffs of the Public Utilities Commissioner of Oregon and the Department of Public Service of the State of Washington of the original cost of the company's utility plant, which examinations had been brought down to December 31, 1936, as of which date the fixed capital accounts of the company were adjusted to agree with the results of the staff investigations. Since the utility's cost of plant had been examined and checked in detail by the staffs of the regulatory bodies of Oregon and Washington, and the records of the company adjusted in accordance therewith at December 31, 1936, it was not necessary to [769] make a detailed analysis of the company's construction accounts. The staff of the Federal Power Commission confined itself in this respect to a review of the working papers of the local regulatory bodies.

Q. Mr. O'Neil, will you tell us then briefly, continuing, as to what were the methods used by the company in preparing its report which it filed with the Federal Power Commission?

A. In considering the methods used by the company in preparing its filed reports with the Federal Power Commission: To conform to the Uniform System of Accounts of the Federal Power Commission, effective January 1, 1937, the company found it necessary to make certain reclassifications of its

(Testimony of John J. O'Neil.)

property which reclassifications were effected through the medium of book analyses of the accounts affected. As a result of this, certain transfers were made between accounts and certain minor inaccuracies were adjusted. Upon the completion of this reclassification, the company computed certain elements of interest during construction, interest on cash balances, interest and taxes on construction material inventories, and an arbitrary apportionment of prior years' administrative and general expenses, all of which were added to the reclassified capital and prorated to the primary accounts.

Because of the previous examinations by the two state [770] commissions, the instant field examination was to a large extent confined to a verification of the company's reclassification of property as between primary accounts, and a check of the propriety of the so-called elements of cost proposed to be added by the company.

Q. And as a result of those studies, was it necessary to make certain adjustments to the company's study? A. It was.

Q. And are those adjustments set forth in the Joint Report, Exhibit 3 in evidence here?

A. They are. Schedule II of the report sets forth these adjustments by classification, and also indicates the effect of each adjustment on the primary accounts.

(Testimony of John J. O'Neil.)

Q. Schedule II begins at Page 10 of the Joint Report, Exhibit No. 3, does it?

A. I believe it does.

Q. Does this Joint Report, Exhibit No. 3, show the nature of the adjustments and the reasons for them?

A. It does. Pages 14 to 22 show the proposed adjustments and the reasons for them.

Q. Since the hearing has commenced, the company has made certain adjustments in its original reclassification study, has it not? A. It has.

Q. Now, taking up the adjustments in the order in [771] which they appear in Schedule No. II of Exhibit No. 3, will you tell us something about them as we go along, starting, say, with the first column of figures on the left, what is meant by "Re-classified as per Company's Original Cost Study",—Statement "F"?

A. Those are the amounts, by classification and primary accounts, which the company claims as its cost of electric plant in the study filed by it with the Federal Power Commission.

Q. That is, in the study now in evidence as Exhibit No. 1? A. That is correct.

Q. And the second column, headed "After Reflecting Proposed Adjustments of Commission Staffs?"

A. Those are the amounts, by classification and primary accounts, recommended by the respective commission staffs.

(Testimony of John J. O'Neil.)

Q. And the third column, headed "Difference Represents the Proposed Adjustments" is the amount by which you have adjusted the claimed cost of the company as set forth in its filed report with the Federal Power Commission?

A. Yes, that is correct. [772]

Q. And this third column, then, is the sum of the proposed adjustments as set forth in the remaining columns in the schedule?

A. Yes, that is correct.

Q. Now we come to the first of the proposed adjustments, which appears in the column headed "To Reverse Company Restatement of Interest During Construction." Will you explain that adjustment?

A. From the effective date of plant operation, July 1, 1914, until December 31, 1925, the records of the company indicate that, other than a specific computation in the case of the construction of the Lincoln steam generating station, no interest during construction was included as a component of construction cost.

As a part of its study of original cost of utility plant, the company calculated interest during construction at the rate of 6% per annum on all work orders the completed cost of which was in excess of $1,000, for the period July 1, 1914, to December 31, 1925. This interest, calculated on 131 work orders aggregating $1,828,025.74 of construction, amounted to $37,020.26, of which $34,959.79 was allocated to

(Testimony of John J. O'Neil.)

the primary accounts in Account 100.1, Electric Plant in Service, and $2,060.47 was allocated to the primary accounts in Account 108, Steam Heating Plant.

In effect, the company found that from fifteen to [773] twenty years ago, it had failed to capitalize interest as a component part of construction cost and is now attempting to record an estimate of that interest as cost of its electric property.

Q. My calculations would tell me that should be fifteen to twenty-five years ago. Is that right?

A. That was the original wording I gave it, but I felt that I might average the period by setting "fifteen to twenty years".

Q. And what treatment have you accorded this restatement in your report?

A. I have reversed the company's proposed restatement. In effect, I have not allowed it.

Q. And what are your reasons for not allowing it?

A. I have scheduled this item for adjustment because I am of the opinion that the reclassification of electric plant pursuant to Electric Plant Instruction 2-D was not intended to require or permit a reaccounting of a utility's own construction costs.

Q. Did the Uniform Classifications of Accounts under which the company operated during this period permit the capitalization of interest during construction?

(Testimony of John J. O'Neil.)

A. In the Uniform Classification of Accounts for Electric Utilities, Gas Utilities and Water Utilities, prescribed by the Railroad Commission of Oregon and effec- [774] tive July 1, 1913, Accounts 236 provided for the capitalization of interest during construction.

Q. Isn't it possible that this failure on the part of the company to capitalize interest during this period was an oversight?

A. I hardly think so. Prior to July 1, 1911, the company capitalized interest during construction on its original construction. From May 1, 1913, to July 1, 1914, the company capitalized an additional $166,800.00 of interest during construction as a development cost. During the period for which restatement is being proposed, interest was computed on a specific project. Certified audit reports of the company during the period of restatement reflected that interest during construction was not computed. The company began computing interest again in 1926, but at that time no attempt was made to make the computation retroactive to July, 1914. This apparent innovation should have manifested itself. The classification of accounts under which the company was operating permitted the capitalization. I cannot believe that this failure to capitalize interest during construction was either an accounting error or an oversight; it was evidently the exercise of managerial discretion. To restate this interest now would constitute a reaccounting of

(Testimony of John J. O'Neil.)

construction costs not required or intended by Electric Plant Instruction 2-D. [775]

Q. Does your adjustment in this respect add or detract from the Company's present book figures?

A. It neither adds nor detracts.

Q. The Company originally submitted a figure, in its study, Exhibit 1 in evidence, of interest during construction of, as you have testified, $37,020.26, which it proposed to capitalize? That is correct, is it not? A. That is correct.

Q. As I understand it, a revised figure has been submitted by Mr. Platt during the course of these proceedings? A. That is also correct.

Q. Now, do the objections which you have stated in your testimony this morning and which you have also stated in your joint report—do those objections still hold to the revised figures equally?

A. Very definitely. [776]

Q. Let's go on, now, Mr. O'Neill, to the fifth of your adjustments in Exhibit No. 3, which is headed "Unsupported Charges to Electric Plant—Common Stock in the amount of $3,500,000. What is that adjustment?

A. In the years 1911 and 1912, Northwestern Electric Company issued common stock in the amount of $10,000,000. On September 16, 1936, the company reduced the par value of this stock from $100 per share to $35 per share, or to $3,500,000. Prior to reclassification, the company carried $3,400,000 of this amount as Non-Operating Fixed

(Testimony of John J. O'Neil.)

Capital and $100,000 in Account 301, Organization. In reclassifying this item, the company included the entire amount of $3,500,000 in Electric Plant in Service, Account 301, Organization.

According to the early minutes of the directors' meetings, the total 100,000 shares of common stock were issued in consideration of the transfer by the subscribers of certain lands with riparian rights, water rights and other properties. According to the minutes of April 15, 1915, the second 50,000 shares of this 100,000 shares were issued, amont other things, for valuable services rendered between the date of the first issue of 50,000 shares and the date of the additional issue of 50,000 shares. [828]

An examination of the books did not support these contentions. No cash was received from the sale of this stock; and it appeared that all of the land with riparian rights, water rights and other properties were paid for and charged to fixed capital by the company at the time of their acquisition.

Q. When was the first 50,000 shares of stock actually issued?

A. I believe it was on March 14, 1911.

Q. And when was the second 50,000 shares actually issued?

A. I believe it was on May 14, 1912.

Q. When was this stock first recorded on the formal books of account of the company?

A. On January 31, 1914, an entry was made charging construction and crediting capital stock in the amount of $10,000,000.

(Testimony of John J. O'Neil.)

Q. And that was the par value of the stock at that time? A. That is right.

Q. And what specific capital account was charged with this $10,000,000?

A. Land and water rights.

Q. But the company did not receive any land or water rights for this stock; is that correct? [829]

A. It did not.

Q. What happened to the charge of $10,000,000 to fixed capital after that?

A. As of December, 1932, the company made an entry transferring $9,600,000 to Miscellaneous Non-Operating Intangible Capital and $400,000 to Organization Account.

Q. And what was the next step in the history of the stock?

A. The stock was next affected by the write-down in par value from $100 to $35 per share on September 16, 1936, which reduced the book value by $6,500,000.

Q. What was the authority for this adjustment from $10,000,000 to $3,500,000?

A. The journal entry states that it was adjusted in accordance with the value determined by the Board of Directors at a meeting held on August 20, 1936.

Q. How did the company record this write-down on its books?

A. An entry was made as of September 16, 1936, charging capital common stock with $6,500,000 and

(Testimony of John J. O'Neil.)

crediting capital surplus with the same amount. A simultaneous entry was made charging capital surplus and crediting fixed capital with the $6,500,000.

Q. Now, as I understand your testimony, prior to this time, $400,000 was being carried in Organization Account [830] and $9,600,000 in Miscellaneous Non-Operating Intangible Capital. Was this reduction of $6,500,000 apportioned between those two accounts?

A. No, the $6,500,000 was credited to the amount of $9,600,000 being carried in Miscellaneous Non-Operating Intangible Capital.

Q. So that after reflecting this entry, Organization Account showed $400,000 and Miscellaneous Non-Operating Intangible Capital showed $3,100,000. Is that right? A. That is correct.

Q. Then what happened after that transaction?

A. As of December 31, 1936, the company made an entry transferring $300,000 from Organization Account to Non-Operating Fixed Capital.

Q. So that at December 31, 1936, immediately prior to reclassification, $100,000 was being carried in Organization and $3,400,000 was classified on the company's books as Non-Operating; is that right? A. That is correct.

Q. Now when the company made this entry at December 31, 1936, reducing the $400,000 carried in Organization Account to $100,000, what was the reason given on the journal entry?

A. To transfer from Operating Fixed Capital

(Testimony of John J. O'Neil.)

to Non-Operating Fixed Capital the difference in value of Fleishhacker's stock selling services, credit backing, and personal [831] services as set up by this company, and the value as determined by Department of Public Service of the State of Washington in their report dated October, 1936.

Q. So that the company had already set a value on Fleishhacker's stock selling services, credit backing and personal services and were carrying that amount in Organization Account just prior to December 31, 1936?

A. That is the way the journal entry reads.

Q. And that amount was $400,000?

A. It was.

Q. And on December 31, 1936, the company reduced this amount to $100,000?

A. That is correct.

Q. Now, in reclassifying its property in the study as reported to the Federal Power Commission, how did the company treat these amounts?

A. It transferred the $3,400,000 appearing as Non-Operating Fixed Capital on its books to Organization Account, and reflected the entire $3,500,000 as Electric Utility Plant in Service.

Q. And how have you treated this $3,500,000 in your report?

A. I have removed this $3,500,000 from Electric Plant in Service and established the amount in Account 107, Electric Plant Adjustments. [832]

(Testimony of John J. O'Neil.)

Q. What is your objection to the inclusion of this amount in Organization Account?

A. Electric Plant Instruction 3-D of the Uniform System of Accounts provides that when the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis. In the instant case, I was unable to find where any consideration had been received for the stock. It appeared that all of the lands with riparian rights, water rights and other properties charged to fixed capital had been paid for by the company at the time of their acquisition. The company received no cash for the common stock. The $3,500,000 appearing in the company's report is a write-up of the plant account. Since such write-ups are includible in Account 107, Electric Plant Adjustments, I have transferred the $3,500,000 to that account.

Q. Is there anything in the books of the company to indicate that any value was received by the company in consideration of the issuance of this stock?

A. There is no evidence in the books of the company to indicate that either cash or property was received in consideration for the issuance of this stock. In the minutes of the meeting of April 12, 1915, there is some mention made of services rendered by the incorporators.

Q. And you have removed the $3,500,000 from Account [833] 301, Organization, and transferred it

(Testimony of John J. O'Neil.)

to Account 107, Electric Plant Adjustments?

A. I have.

Q. And you have placed the amount in Account 107, Electric Plant Adjustments, because it is your opinion that it is an inflation of the capital account? A. That is also correct.

Q. Now, Mr. O'Neil, you said a little while ago that from December 31, 1932, through December 30, 1936, the company had on its books in the Organization Account an amount of $400,000 which represented a value which it had placed on certain stock selling services, credit backing and personal services rendered by Messrs. Herbert and Mortimer Fleishhacker. Just how was this value arrived at by the company?

A. I believe it was a judgment valuation by Mr. C. W. Platt.

Q. And that is the same Mr. C. W. Platt who has testified in this proceeding?

A. That is right.

Q. And did you make any investigation of this valuation to determine whether or not it did contain elements which could be construed as a consideration received for the issuance of this stock?

A. I did. The details of the valuation placed upon [834] these services by Mr. Platt appear in testimony taken before the Public Utilities Commissioner of Oregon and the Department of Public Service of the State of Washington as a result of previous investigations of the rates, charge and services of the company.

(Testimony of John J. O'Neil.)

Q. When were these hearings held?

A. I believe it was during 1932, 1933 and 1934.

Q. Did you read the entire testimony taken before both state commissions?

A. I believe I did.

Q. And it was in this testimony that Mr. Platt advanced the judgment valuation of $400,000 for promotional and financing services?

A. It was.

Q. And stated these services were the total consideration received for this stock?

A. That is correct.

Q. And the company actually recorded this valuation on its books in the Organization Account in December of 1932? A. It did.

Q. And carried this $400,000 as such until December 31, 1936, at which time it was reduced to $100,000? A. That is also correct.

Q. And you are satisfied that no consideration was received by the company for the issuance of this stock? A. I am. [835]

Q. Now just for a moment let us consider the recommendations which you make in your report. I think we can consider your first four adjustments as one, those dealing with the restatement of interest during construction, interest on average cash balances, interest and taxes on construction materials, and prior years' administrative and general expenses. What are your recommendations with respect to these restatements?

(Testimony of John J. O'Neil.)

A. These four adjustments are not on the company's books. They are entries which the company proposes to make. For the reasons which I have previously stated, it is my recommendation that the Commission disallow these attempted restatements. There is no adjustment to be made on the books.

Q. And as to the $3,500,000 of common stock? [842]

A. I have removed that item from utility plant and established it in Account 107, Electric Plant Adjustments. I have recommended that the company submit a plan for its disposition. In view of the nature of the amount, constituting as it does a write-up of plant, I believe it should be disposed of as quickly as possible. [843]

MELWOOD W. VAN SCOYOC,

called at a witness on behalf of the Federal Power Commission, being first duly sworn, testified as follows:

Direct Examination

By Mr. Slaff:

Q. Please give your name and also your address and your position with the Federal Power Commission.

A. My name is Melwood W. Van Scoyoc, 411 Hillwood Avenue, Falls Church, Virginia. I am Chief of the Division of Original Cost of the Federal Power Commission.

(Testimony of Melwood W. Van Scoyoc.)

Q. Would you be good enough to state your experience?

A. I was graduated from Oregon State College in 1927 with the Degree of Bachelor of Science in Electrical Engineering. Subsequently, I took courses in accounting from the Oregon Institute of Technology and the Walton School of Commerce. I am a registered professional engineer in the State of Oregon.

On June 20, 1927, I entered the employ of the then Public Service Commission of Oregon as Assistant Engineer, which position I held until January 1, 1930. During this period my duties included the taking of an inventory of a large portion of the property of West Coast Power Company and the pricing of same on the basis of reproduction cost. I also made certain studies for the purpose of determining the construction cost of gas mains of Portland Gas & Coke Com- [845] pany. In connection with a valuation and rate case before the Commission, I made an audit of the continuing property records and property accounts of the electric utility property of Portland Electric Power Company.

From January 1, 1930, to April 1, 1931, I was in the employ of the Portland Electric Power Company in the capacity of Assistant Valuation Engineer. My work was in connection with the Company's continuing property record system and from time to time I also made other special studies.

(Testimony of Melwood W. Van Scoyoc.)

From April 1, 1931, to April 1, 1935, I was employed by the Public Utilities Commissioner of Oregon as statistical engineer. In this position I was in direct charge of the auditing and investigation of construction costs of the property of Northwestern Electric Company, The California-Oregon Power Company, and Inland Power & Light Company. I also assisted in the various phases of these proceedings and several other proceedings before the Commissioner.

On April 1, 1935, I was appointed Utility Auditor and on July 1, 1936, was given the title of Chief Accountant, which position I held until November 15, 1938. During this period of employment I supervised and directed the work of the Department of Finance and Accounts of the Commission, which included the auditing and analysis of the annual reports of public utilities and railroads, supervision and control of accounting methods and practices of utilities and [846] railroads including the auditing of their accounts, the preparation and recommendation for adoption by the Commissioner of Systems of Accounts and annual and other report forms, the making of studies and recommendations relative to applications of public utilities to issue securities and to purchase, sell, lease, or merge public utility property, analysis of transactions between affiliated interests, the supervision of the annual budgets of public utilities, studies relative to the determination of the original cost of utility

(Testimony of Melwood W. Van Scoyoc.)

property, and depreciation rates, the preparation of reports and analyses of net operating income, operating expenses, revenues, and investments for presentation of evidence in valuation, rate and other proceedings before the Commission.

I was also in charge of the Commissioner's internal accounting and budget system, including the accounting for funds received and the disbursement thereof for the regulation of public utilities and railroads. Since entering the employ of the Federal Power Commission in November 15, 1938, I have been in direct charge of the work of the Commission relative to the verification of the original cost studies submitted by public utilities pursuant to Electric Plant Instruction 2-D of the Commission's Uniform System of Accounts.

Q. As chief of the Division of Original Cost of the Federal Power Commission, are you familiar with the joint [847] report on the reclassification and original cost studies of electric plant as of June 1, 1937, of Northwestern Electric Company which is Exhibit No. 3 in this proceeding? A. Yes.

Q. Do you concur in the conclusions and recommendations set forth in this report?

A. Yes. The report was prepared under my supervision and direction.

Q. And you have heard the testimony of Mr. Charles W. Smith in this proceeding, have you not?

A. I have.

(Testimony of Melwood W. Van Scoyoc.)

Q. Do you concur in Mr. Smith's testimony relative to the accounting principles involved in this proceeding? A. I do.

Q. At the time the Public Utilities Commissioner of Oregon prescribed the Uniform System of Accounts for Electric Utilities, January 1, 1937, which I understand will be offered in evidence in this proceeding by Counsel for the Oregon Commission, were you not the Chief Accountant of that Commission and in charge of accounting matters?

A. Yes, I was.

Q. And did you recommend to the Commissioner that he adopt this system of accounts?

A. Yes, I did. [848]

Q. Is this system of accounts identical with the Federal Power Commission Exhibit No. 6 herein with respect to those provisions which bear upon this proceeding? A. Yes, it is.

Q. At that time were you of the opinion that the new System of Accounts was intended to permit or would permit a reaccounting of the Company's past expenditures?

A. No. And in this connection I desire to state that prior to the adoption of this System of Accounts by the Oregon Commission a conference was held with the accounting officers of the electric utilities under the Commission's jurisdiction and also a formal hearing was held at which time representatives of electric utilities appeared and were heard.

(Testimony of Melwood W. Van Scoyoc.)

Q. Were representatives of Northwestern Electric Company present at that hearing?

A. Yes. Comments and suggestions relative to the proposed System of Accounts were submitted in great detail by representatives of Northwestern Electric Company. No mention was ever made at the conference or hearing by any representative of Northwestern Electric Company or of any other utility subject to the Commissioner's jurisdiction, that the new Uniform System of Accounts contemplated a reaccounting process in reclassifying its plant accounts.

Q. Was Mr. Platt also present on behalf of the Com- [849] pany? A. Yes, he was.

Q. Did you make any recommendations to the Commissioner relative to this System of Accounts?

A. I did. And in making my recommendations to the Commissioner that he prescribe a new Uniform System of Accounts for electric utilities and similar systems for telephone, gas, water and steam heat utilities, such recommendations were made with the firm belief that the new System of Accounts would not destroy the usefulness of the figures which had been reported to the Commission as operating income or fixed capital for many years in the past, or result in the inflation of the electric plant accounts of these utilities with millions of dollars of charges which had been previously charged against the rate payers as operating expenses.

(Testimony of Melwood W. Van Scoyoc.)

Mr. Laing: Mr. Examiner, I am inclined to take exception to this line of testimony, which is not in response to the question which was asked him, and which involves a wholly uncalled-for commentary on matters which have no direct relation to the question he was asked, an

The Trial Examiner: I think the response does involve some commentary. However, the Examiner and the Commission, too, will review the testimony, and will be perfectly able to separate the wheat from the chaff, so to [850] speak.

By Mr. Slaff:

Q. Now, was it contemplated that in complying with electric plant Instruction 2-D of the Uniform System of Accounts, any change need be made in the plant accounts for utility's own construction other than the correction of accounting errors?

A. It was not.

Mr. Laing: May I ask, Mr. Slaff, if a question can properly be confined to Mr. Van Scoyoc's opinion?

By Mr. Slaff:

Q. Well, in the first place, is that an expression of your opinion? A. That is right.

Q. And did it also appear to you to be the expression of the opinion of any of the utilities which appeared before you at the hearing which was held?

A. Well, there was no opinion to the contrary evidenced at the conference or hearing.

(Testimony of Melwood W. Van Scoyoc.)

Q. Now, with respect to the work which might be required to be done by Northwestern Electric Company in complying with this Electric Plant Instruction 2-D, what was your belief with respect to what was required of it?

A. Well, it was my belief that all that was required was a reclassification of its plant account, inasmuch as the [851] Company had never had any acquisitions of operating units or systems.

In other words, its own construction was already stated on its books at cost.

Q. Now, have several other Oregon utilities submitted original cost studies in conformity and in response to the requirements of the Federal Power Commission?

A. They have, and of these companies which have submitted original cost studies in conformity with the requirements of the Federal Power Commission only Northwestern Electric Company and its sister company, Pacific Power & Light Company, have made a reaccounting of their past expenditures and restated a portion of such expenditures in their plant accounts.

Q. Now, will you tell us, please, approximately how many field examinations have been made by your Division, the Division of Original Cost, with respect to similar studies submitted by other utilities?

A. The Division of Original Cost has so far examined in the field approximately 45 original cost

(Testimony of Melwood W. Van Scoyoc.)

studies representing a fairly broad cross-section of electric utilities subject to the Commission's jurisdiction, both on the basis of holding company systems and also geographically.

Q. How about office studies that have been made by your Division? [852]

A. Office studies have been made of approximately two hundred utilities.

Q. Office studies have been made, that is by your Division of Original Cost, of reports that have been submitted by some two hundred companies?

A. That is correct.

Q. Now, will you tell us whether in these studies which your division has examined both in the field and in the office, a small percentage or a large percentage of the companies have used the reaccounting process?

A. Only a small percentage of the companies have used such a process.

Q. And will you detail that somewhat more fully?

A. Only three holding-company systems, so far as we know, have followed such a process, that is the operating companies within those systems, they being the Electric Bond & Share Company system, American Water Works & Electric Company system, and the Commonwealth Edison group of Illinois. In addition, I know of only one independent company which has used such a process—it being

(Testimony of Melwood W. Van Scoyoc.)

the Sioux City Gas & Electric Company of Sioux City, Iowa.

Q. And I take it that there may possibly be others which you will discover through your field examination? A. That is possible.

Q. Now will you tell us, on the other hand, some [853] details with respect to the operating companies, the holding company systems which you have examined, which have not used this reaccounting process?

A. We have found that a good many holding company systems have not followed the reaccounting process in meeting the requirements of the Commission with respect to electric plant instruction 2-D. They are the systems of American Gas & Electric Company, Middle West Utilities Company, Midland United Company, Associated Gas & Electric Company, Engineer's Public Service Company, Standard Gas & Electric Company, New England Power Association, Community Power & Light Company, People's Light & Power Corporation, Eastern Utilities Associates, United Light & Power Company, Utilities Power & Light Company, the North American Company and Commonwealth & Southern Corporation.

Q. And how about independent companies?

A. There are a number of independent companies have likewise not followed the reaccounting process—some of these are the Duke Power Com-

(Testimony of Melwood W. Van Scoyoc.)

pany, Southern California Edison Company, and Boston Edison Company.

Q. Do you know who made the study pursuant to Instruction 2-D for the Duke Power Company?

A. Haskins & Sells made the study dealing with the property acquired in 1935 by Duke Power Company from its principal subsidiary, Southern Public Utilities Company. [854]

Q. Is that the same Haskins & Sells of which Mr. Bell, who testified in this case, is a partner?

A. Yes, it is.

Q. Has this study been officially submitted to the Federal Power Commission?

A. Yes, it has.

Q. Have members of your staff checked this study in the field? A. Yes, they have.

Q. Have you personally checked this study?

A. Yes, I have reviewed the Company's study and the work of my staff. [855]

Q. Approximately how much fixed capital was involved? A. Approximately $63,000,000.

Q. Mr. Van Scoyoc, I believe you previously stated that you had made an audit of the fixed capital accounts of Northwestern Electric Company?

A. Yes, it was made in connection with a rate case before the Oregon Commission, (UF-526). A portion of the audit was made personally by me and other portions under my direction.

Q. What was particularly involved in this audit?

(Testimony of Melwood W. Van Scoyoc.)

A. The audit was for the purpose of ascertaining whether the amounts included in the company's fixed capital accounts from the inception of the company were proper capital charges and, if so, whether they were properly classified. Fixed capital was classified prior to 1925 on the basis of the 1913 Oregon system and it was necessary to reclassify the same in accordance with the 1925 Oregon classification which was then in effect. Approximately 1335 adjustments affecting fixed capital and other accounts resulted from the initial audit. In 1936 and also in 1937, further audits were made which brought the fixed capital accounts of the company on an adjusted basis down to December 31, 1936.

Q. In these audits which you speak of were there any restatements made of interest during construction, admini- [856] strative expenses or other items of like character to administrative expenses which had been previously charged to income?

A. No, the fixed capital accounts were adjusted on the basis of the actual charges to those accounts. There was no reaccounting such as is now proposed. So far as I know no such process was ever considered.

Q. Did the company finally adjust its books as a result of these audits so that as of December 31, 1936 the company and the Oregon and Washington Commission staffs were in agreement relative to the company's fixed capital accounts?

(Testimony of Melwood W. Van Scoyoc.)

A. Yes, it can be said with respect to the detailed fixed capital accounts that there was an absolute agreement between the company and the Commission staffs. [857].

Q. Now, I don't believe I asked you about the item of $34,959.79, which subsequently has been reduced by the company to $31,389.87, entitled "Reversal of Restatement of Interest During Construction" on page 14 of Exhibit 3. What is your opinion with respect to this item?

A. This item represents a calculation of interest during construction during the period July 1, 1914 to December 31, 1925, on certain work orders, it not being the practice of the company to capitalize interest during construction during this period except in the case of the construction of the Lincoln steam plant. My objection to the retroactive capitalization at this time is for the reason that I do not believe the Uniform System of Accounts of the Federal Power Commission permits a reaccounting of this item. In other words, the non-capitalization of interest during construction was not an oversight or inadvertent omission on the part of the management but was the exercise of managerial discretion. At the time the audit was made of the construction expenditures of the Northwestern Electric Company previously mentioned, we found this situation to exist. It was not considered necessary at that time to correct the non-capitalization of interest nor do

(Testimony of Melwood W. Van Scoyoc.)

I think it necessary or proper to so do now. [863]

Q. Are you familiar with the item of $3,500,000 representing the par value of the company's common stock which has been included by the company in Account 301, Organization, and which in the Joint Report, Exhibit No. 3 in evidence, was reclassified by the staff of the two Commissions to Account 107, Electric Plant Adjustments?

A. Yes, I am familiar with this item.

Q. Is it your opinion that this item should be included in Account 107, Electric Plant Adjustments? A. Yes.

Q. What are your reasons?

A. Account 107 was designed to include among other things direct book write-ups which is exactly what this item represents. The amount was originally $10,000,000 and was written down by a charge to capital surplus in 1936 to $3,500,000. It was originally created by a charge to construction in January 1914 with a corresponding credit to capital stock.

According to the minutes of the Trustees' meeting held on April 15, 1912, the original $5,000,000 of stock was issued in consideration of the transfer to the company of certain rights and physical property by the subscribers, including their services. According to the minutes of the Trustees' meeting held on April 12, 1915, the second $5,000,000 was issued as additional compensation to the same [864] sub-

(Testimony of Melwood W. Van Scoyoc.)

scribers among other things for services performed between March 14, 1911 and the date of issuance thereof. Although the Board of Trustees adopted a specific resolution on April 12, 1915, ratifying the issuance of this second $5,000,000 of common stock, it appears that the entire $10,000,000 of common stock had been actually issued by about May 14, 1912.

During the course of the investigation of the accounts of the company in connection with the previously mentioned rate proceedings before the Oregon Commission, the staff of the Commission determined that no property or rights were acquired by Northwestern Electric Company from the subscribers, but that all such property and rights listed on the schedules attached to the resolutions adopted on April 15, 1912 and June 12, 1912 had been previously purchased from the funds of Northwestern Electric Company. This has been previously admitted by the company.

There is no question in my mind but that the item of $3,500,000 is the remaining balance of the original $10,000,000 write-up and should be included in Account 107, Electric Plant Adjustments.

Q. Do you believe that the $3,500,000 should be permanently retained in Account 107, Electric Plant Adjustments? [865]

A. No, the item belongs in Account 107 for the purpose of reclassification only and pending its final

(Testimony of Melwood W. Van Scoyoc.)

disposition in accordance with the provisions of that account.

Q. What plan of disposition do you believe should be followed?

A. I have always maintained that this should be expunged from the Company's books. I still am of that opinion.

Q. In what manner could the disposition be accomplished?

A. As a matter of accounting there are two avenues open for the disposition of the item—one being a further write-down of the common stock such as occurred in 1936 and the other being the amortization of the item through Account 271, Earned Surplus. [871]

EXHIBIT No. 42

Federal Power Commission
Washington, D. C.

ORDER No. 42

(Adopted June 16, 1936)

Prescribing a System of Accounts for public utilities and licensees under the Federal Power Act.

The Federal Power Commission acting pursuant to authority granted by the Federal Power Act particularly Section 301(a), 304(a), and 309, and Paragraph (13) of Section 3, and Section 4(b)

thereof, and finding such action necessary and appropriate for carrying out the provisions of said Act, hereby adopts the accompanying system of accounts entitled, "Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act," and the rules and regulations contained therein; and

It is hereby ordered:

(1) That said system of accounts and said rules and regulations contained therein be and the same are hereby prescribed and promulgated as the system of accounts and rules and regulations of the Commission to be kept and observed by public utilities subject to the jurisdiction of the Commission and by licensees holding licenses issued by the Commission, to the extent and in the manner set forth therein;

(2) That said system of accounts and rules and regulations therein contained shall, as to all public utilities now subject to the jurisdiction of the Commission and as to all present licensees, become effective on January 1, 1937, and as to public utilities and licensees which may hereafter become subject to the jurisdiction of the Commission, they shall become effective as of the date when such public utility becomes subject to the jurisdiction of the Commission or on the effective date of the license;

(3) That a copy of said system of accounts and rules and regulations contained therein be forthwith served upon each public utility subject to the jurisdiction of the Commission, and each licensee

or permittee holding a license or permit from the Commission.

This system of accounts supersedes the system of accounts prescribed for licensees under the Federal Water Power Act; and Order No. 13, entered November 20, 1922, prescribing said system of accounts, is rescinded effective January 1, 1937.

Adopted by the Commission on June 16, 1936:

LEON M. FUQUAY,
Acting Secretary.

EXHIBIT No. 44

Federal Power Commission

ELECTRIC PLANT INSTRUCTION 2 D— UNIFORM SYSTEM OF ACCOUNTS

It appearing to the Commission:

(1) That Electric Plant Instruction 2 D of the Uniform System of Accounts, prescribed for public utilities and licensees, provides as follows:

> "D. Not later than 2 years after the effective date of this system of accounts, each utility shall have completed the studies necessary for classifying its electric plant as of the effective date of this system of accounts in accordance with the accounts prescribed herein and it shall submit to the Commission the entries it proposes to make to carry out the provisions of this instruction. It shall submit also a com-

parative balance sheet showing the accounts and amounts appearing in its books as of the effective date of this system of accounts and the accounts and respective amounts as of the same date after the proposed entries shall have been made."

(2) That it is necessary and desirable in order adequately to consider the adjusting entries specified in the above-named instruction that data relative to the history of each public utility, its acquisitions of electric operating units or systems, the original cost thereof, the amounts entered in the books in respect thereto, the method of determining original cost, and much related information be furnished.

It is ordered:

That in submitting the information called for in Electric Plant Instruction 2 D of the Uniform System of Accounts, prescribed for public utilities and licensees, each utility shall furnish, insofar as applicable, the following statements properly sworn to by the officer in responsible charge of their compilation:

Statement A showing in outline the origin and development of the company including, particularly, a description (giving names of parties and dates) of each consolidation and merger to which the company, or a predecessor, was a party and each acquisition of an electric operating unit or system.

Statement B showing for each acquisition by the reporting company or any of its predecessors of an electric operating unit or system, the original cost, estimated, if not known, the cost to such company and the amount entered in the books in respect thereto as of the date of acquisition. If the depreciation, retirement or amortization reserve was adjusted as of the date of acquisition and in connection therewith, a full disclosure of the pertinent facts should be made. The difference between the original cost and the amount entered in respect thereto of each acquisition of an electric operating unit or system, as of the date of acquisition, should be clearly stated, and a summary of all transactions affecting such difference between the date of the respective acquisition and January 1, 1937, and the resultant amount on the latter date, should be set forth. The amount to be included in Account 100.5, Electric Plant Acquisition Adjustments, as of January 1, 1937, shall be subdivided so as to show the amounts applicable to (a) electric plant in service, (b) electric plant leased to others, and (c) electric plant held for future use. Whenever practical, such amount shall be classified according to nature, i.e., going value, structural value, etc.

Where estimates are used in arriving at original cost or the amount to be included in Account 100.5, a full disclosure of the method and underlying facts should be given. The

method of determining the original cost of the electric plant acquired as operating units or systems should be described in sufficient detail to permit a clear understanding of the nature of the investigations which were made for that purpose.

Statement C showing any amounts arrived at by appraisals, recorded prior to January 1, 1937, in the electric plant accounts (and not eliminated) in lieu of cost to the reporting company. This statement should give the full journal entry at the time the appraisal was originally recorded and if the entry had the effect of appreciating or writing-up the electric plant account, the amount of the appreciation or write-up should be traced, by proper description and explanation of changes, from the date recorded to January 1, 1937.

Statement D showing electric plant as of December 31, 1936, as classified in the books of account immediately prior to reclassification in accordance with the new system of accounts, including, under a descriptive heading, any unclassified amounts applicable jointly to the electric department and other departments of the utility.

Statement E showing summary of adjustments necessary to state, as of January 1, 1937, Account 100, Electric Plant, including all its subsidiary accounts, and Account 107, Electric

Plant Adjustments, as prescribed in the Uniform System of Accounts.

Statement F showing electric plant (balance sheet Account 100) as of January 1, 1937, classified according to the accounts prescribed in the Uniform System of Accounts, effective on that date, and showing also the amount includible in Account 107, Electric Plant Adjustments.

Statement G giving a comparative balance sheet, as of January 1, 1937, showing the accounts and amounts appearing in the books before the adjusting entries have been made and after such entries shall have been made.

Statement H giving a suggested plant for depreciating, amortizing, or otherwise disposing in whole or in part of the amounts, as of January 1, 1937, includible in Account 100.5, Electric Plant Acquisition Adjustments, and Account 107, Electric Plant Adjustments.

Statement I giving the following statistical information relative to electric plant:

Production Plant

Steam Production

Separately for each steam plant: Name of plant, date of construction, name plate generating capacity (kw) as originally constructed and as at present, also name plate capacity and date of installation of each addition to generating capacity. The original cost,

where available, by Accounts 310 to 316, of each steam production plant.

Hydraulic Production

Separately for each hydro plant: Name of plant, date of construction, capacity of reservoirs (acre feet), name plate generating capacity (kw) as originally constructed and as at present, also name plate capacity and date of installation of each addition to generating capacity. The original cost, where available, by Accounts 320 to 326, of each hydraulic production plant.

Internal Combustion Engine Production

For each internal combustion engine plant: Name of plant, date of construction, name plate generating capacity (kw) as originally constructed and as at present, also name plate capacity and date of installation of each addition to generating capacity. The original cost, where available, by Accounts 330 to 336, of each internal combustion engine production plant.

Transmission Plant

Overhead Transmission Lines

For each overhead transmission line or for each group of transmission lines of the same voltage, same general type of construction and same number of circuits per structure: the voltage, length in miles, type of construction, kind and size of conductor. The original

cost as of January 1, 1937, where available, by Accounts 340, 341, 342, 344, 345, 346, and 349, of each such line or group of lines.

Underground Transmission Lines

For each underground transmission line or for each group of transmission lines of the same voltage, same general type of construction and same number of circuits per structure: The voltage length in miles and type of construction. The original cost as of January 1, 1937, where available, by Accounts 340, 341, 342, 347, 348 and 349, of each such line or group of lines.

Transmission Substations

For each substation: Function, capacity (kva), high and low voltages of transformers, description and capacity of special items of equipment.

Distribution Plant

Overhead System[a]

Number of pole and circuit miles, number of active meters or services connected (if available), description and number of each type of pole or tower.

Underground System[a]

Number of circuit miles, number of active meters or services connected (if available),

[a] If number of active meters or services is not available separately for overhead and underground systems, report totals.

description of type of construction and general statement of any special construction problem.

Distribution Substation

General description of number, capacity (kva), and high and low voltages of transformers.

Line Transformers

Number and capacity.

Street Lighting and Signal Systems

Description and number of each type of street lighting standard, number and wattage of lamps, and description of signal system.

General Plant

Description of principal structures and improvements.

Number and type of transportation vehicles and appurtenant equipment.

Description of store, shop, and laboratory equipment.

Description of communication equipment.

Description of miscellaneous equipment.

* * * * * * *

Adopted by the Commission on May 11, 1937.

LEON M. FUQUAY,
Acting Secretary.